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A TREATISE
ON THE
MODERN LAW OF CORPORATIONS
WITH REFERENCE TO
FORMATION AND OPERATION
UNDER GENERAL LAWS

BY
ARTHUR W. MACHEN, Jr.
OF THE BALTIMORE BAR

IN TWO VOLUMES
VOLUME II.

BOSTON
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1908

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§ 1012. **Meaning of "Ultra Vires."** — The phrase "*ultra vires*," while convenient and appropriate, has unfortunately been so often misused, or employed with a meaning other than that which it most properly bears, that it has lost the univocal character which should distinguish all legal terms or "words of art." In its proper sense, it denotes some act or transaction on the part of a corporation which, although not unlawful or contrary to public policy if done or executed by an individual, is yet beyond the legitimate powers of the corporation as they are defined by the statutes under which it is formed or which are applicable to it, or by its charter or incorporation paper. The misuse of the term consists in applying it to any act or transaction which is beyond the lawful powers of any person. For instance, the acts of an agent in excess of his authority are said to be *ultra vires*. So, acts which the directors of a corporation should leave to the shareholders and not undertake themselves are said to be *ultra vires*. Again, no man has the lawful power to commit illegal acts, and hence any violation of law is said to be *ultra vires*. But all these uses of the phrase are unfortunate and confusing, and should be rejected in favor of the narrower meaning as defined above.

§ 1013. **Scope of Chapter** — *Not to discuss what is beyond the Powers of the Corporation.* — In this place it is not intended to discuss the powers of corporations or to set forth what matters

are *ultra vires*. So far as that subject is to be treated at all, it has already been dealt with in connection with the subject of the incorporation paper.¹ Here we shall assume that the transaction in question is *ultra vires* of the corporation.

§ 1014. *Nor preventive Remedies for Ultra Vires Acts.* — Nor shall we here consider the means of preventing *ultra vires* acts. The right of a shareholder to ask the aid of a court of equity in preventing *ultra vires* transactions is treated below.² The power of the state, or of the attorney-general representing the state, to intervene and, by injunction or other writ, confine a corporation within its legitimate powers falls within the general subject of the relation of incorporated companies to the state and is not within the scope of this treatise.

§ 1015. *Nor liability of Directors and Officers for Ultra Vires Acts.* — Nor shall we now consider the consequences to the directors, officers, and agents of corporations who engage on behalf of the company in transactions that are beyond its powers. That subject will be treated below in connection with the liabilities and disabilities of directors.³

§ 1016. *Nor Penal or Criminal Liability of the Company.* — We shall also exclude from view all questions as to the penal or quasi-criminal liability of corporations to the state, which is enforced by a proceeding in the nature of *quo warranto* or *scire facias* to terminate the corporate existence, for the misuse of corporate powers by engaging in *ultra vires* transactions, — a topic which falls within the subject of the dissolution of corporations. We shall also exclude the strictly criminal liability which is carried out by the ordinary process of indictment, — a matter which falls under the head of the relation of the corporation to the state. The discussion will be confined to the liability of the parties to *ultra vires* contracts and to the liability of the company for *ultra vires* torts.

§ 1017-§ 1071. ULTRA VIRES CONTRACTS.

§ 1017. **Ultra Vires Contracts relating to internal corporate Affairs distinguished.** — There is, however, one class of so-called *ultra vires* contracts which will not be considered in this

¹ Supra, § 46-§ 108. Cf. infra,

² Infra, § 1153, § 1154.

§ 1154.

³ Infra, § 1517-§ 1524, § 1641.

place. That is to say, certain contracts relative to corporate matters, such as contracts for an overissue of shares, contracts for an unauthorized reduction of capital, contracts for the issue of shares at a discount, contracts for the purchase of the company's own shares, and the like, are not to be now taken up. Such contracts are discussed in connection with the particular subjects to which they relate, such as the issue of shares, reduction of capital, etc. Contracts of that sort are of course peculiar to corporations. In the nature of things, they could not be entered into by an individual. They involve different questions from those relating to *ultra vires* contracts in general. The present chapter deals with the more general class of contracts — contracts such as might be made, and made legitimately, by any individual, the only objection to their validity in the case of a corporation being the fact that they are not within its powers as defined in its act of incorporation or incorporation papers.

§ 1018-§ 1020. *Objections to holding Ultra Vires Contracts to be binding.*

§ 1018. **Objection that Corporation could not and therefore did not make the Contract.** — The objections to holding mere *ultra vires* contracts to be binding are two. First, it is argued that, the contract in question being, *ex hypothesi*, beyond the powers of the corporation as limited by the law of its creation, the corporation, the legal entity, could not have made it. According to this view, whilst the company may appear to have made the contract, yet in reality it has not done so. The vice in this argument consists in laying undue stress on the corporate fiction. For corporations are composed of natural persons who can and often do under cover of the corporate machinery engage in transactions and enter into contracts that are *ultra vires* of the corporation; and the spirit of modern times is such that the law must accept this fact, and must recognize that justice can be accomplished only by treating such contracts as made by the corporation.

§ 1019. *Ultra Vires Character of Contract as Evidence that Agent making it was in fact unauthorized.* — Of course, however, — and this proposition, in the midst of all the diversity

of opinion surrounding the law of *ultra vires* contracts, commands universal assent, — where a contract is *ultra vires* of the corporation much stronger evidence of authority on the part of the company's agents to make it must be shown than if the contract were within the company's powers. For to engage in transactions that are *ultra vires* of the corporation is beyond the scope of the authority of any corporate agent or agents¹ — that is, beyond the authority conferred upon him or them, directly or indirectly, by the shareholders. Indeed, unless the corporate body themselves authorize or ratify an *ultra vires* contract, the agreement will be unenforceable against the company for the same reason that any contract made by an agent beyond the scope of the authority delegated to him fails to bind the principal.

§ 1020. **Objection that Ultra Vires Contract is Illegal.** — The second objection to the enforceability of *ultra vires* contracts is that while corporations can and do make them yet they are made in defiance of law, are illegal, and like other illegal contracts are unenforceable. The weight of this argument must be admitted. But although the making of *ultra vires* contracts by a corporation is undoubtedly prohibited by law, yet the illegality is of a very peculiar kind, and hence one should not hastily conclude that such contracts must necessarily be governed by the same rules as other illegal contracts — contracts, for example, that are *mala in se*. The illegality of *ultra vires* contracts depends upon no policy of the law as to the subject matter to which they relate, but solely upon the fact that they are not within the company's powers as defined in its act of incorporation or incorporation paper. To apply to them precisely the same rules that have been deemed necessary in order to discourage illegal contracts in general and to relieve the courts from the disagreeable task of nicely adjusting equities between various parties all of whom have been acting contrary to good

¹ *Pennsylvania, etc. Nav. Co. v. Link-Dandridge*, 8 G. & J. (Md.) 248, 272, 318-319; 29 Am. Dec. 543 (decision as to defendant's first and second prayers); *Alexander v. Cauldwell*, 83 N. Y. 480; *McLellan v. Detroit File Works*, 56 Mich. 579; 23 N. W. 321; *George v. Nevada Central R. R. Co.*, 22 Nevada 228; 38 Pac. 441. not been very strictly applied: *Link-hauf v. Lombard*, 137 N. Y. 417; 33 N. E. 472; 33 Am. St. Rep. 743; 20 L. R. A. 48. As to the rule that a contract should be so construed, if possible, as that it shall be within and not beyond the powers of the corporation, see *Beasley v. Aberdeen, etc. R. Co.* (N. Car.), 59 S. E. 60. In some cases, this doctrine has

morals or to the policy of the law, would be both illogical and unjust. If, therefore, *ultra vires* contracts be conceded to be illegal, they should be governed by rules which as applied to this peculiar kind of illegality are best adapted to promote the policy of the law and the ends of justice.

§ 1021. **Confusion in Cases.** — The authorities are in utter confusion. No court consistently adheres to either view — the view that a corporation cannot make an *ultra vires* contract, or the view that *ultra vires* contracts are illegal. Indeed, difficulty is often experienced in determining upon which theory even in a single case the court has acted.

To attempt to unravel the tangle so as to show precisely what rules of law are adopted in each state would be a protracted, if not impossible, task. The situation is such that the law in any given state can be determined, if at all, only by a minute examination of the local decisions. In the present chapter a statement will be found of the leading views which have been taken of the matter — such, for example, as the English doctrine and the doctrine of the federal courts.

§ 1022-§ 1026. *The Rule as to Contracts of Corporations Chartered by the Crown — Historical Review.*

§ 1022. **Doctrine that Chartered Corporation is bound by all sealed Contracts to same Extent as a Natural Person.** — In respect to liability of corporations on *ultra vires* contracts, English judges seem to draw a distinction between modern statutory corporations, whether formed under a general law or special act, and the old common law corporations created by royal charter. As to the former, the English law is in the main clearly settled; but as to the latter, the law of the subject is involved in the mists of antiquity which obscure so much that would be interesting in respect to corporations chartered by the crown. Blackstone dismisses the subject with the brief platitude, "The general duties of all bodies politic, considered in their corporate capacity, may, like those of natural persons, be reduced to this single one, of acting up to the end or design, whatever it be, for which they were created by their founder."¹ But in England, in modern times, the notion has obtained credence that a corpora-

¹ 1 Black. Comm. 483.

tion created by royal charter while perhaps liable to be dissolved at the suit of the attorney-general for engaging in *ultra vires* transactions,¹ is yet bound by all its contracts, even though *ultra vires*, to the same extent as an individual would be. This doctrine is expressed by a recent English text-writer of authority: "There still, however, subsists a difference of a fundamental character between a chartered company and a company formed under a special Act or registered under the Companies Acts, and it is this: at common law a corporation created by the king's charter has power, as was determined in the *Sutton's Hospital Case*,² to deal with its property, to bind itself by contracts, and to do all such acts as an ordinary person can do, and so complete is this corporate autonomy that it is unaffected even by a direction contained in the creating charter in limitation of the corporate powers. For the common law has always held that such a direction of the Crown — though it may give the Crown a right to annul the charter if the direction is disregarded — cannot derogate from that plenary capacity with which the common law endows the company, even though the limitation is an essential part of the so-called bargain between the Crown and the corporation. . . . This feature — the unrestricted corporate capacity of the chartered company — is in marked contrast to the strict delimitation by the legislature to its defined objects of the statutory or registered company."³ The same idea has been accepted in a number of modern English cases,⁴ although in none of them was it in any degree necessary to the decision, or even part of the *ratio decidendi*.

¹ But see *London County Council v. Attorney-General* (1902), A. C. 165 (where the court seems to have assumed that a common-law corporation could not be restrained by injunction at the instance of the attorney-general from exceeding its chartered powers).

² *Sutton's Hospital Case*, 10 Co. 1.

³ *Palmer's Company Law*, 3d ed., p. 3.

⁴ *Riche v. Ashbury Ry., etc. Co.*, L. R. 9 Ex. 224, 263; *Ashbury Ry., etc. Co. v. Riche*, L. R. 7 H. L. 653; *Wenlock v. River Dee Co.*, 36 Ch. D. 675 n., 685 n.

See also an oft-quoted remark of

Baron Parke in *South Yorkshire Ry., etc. Co. v. Great Northern Ry. Co.*, 9 Ex. 55, 84–85, "In partnerships, where all the members do not concur in the contract . . . one partner may bind the other in all contracts within the scope of their ordinary partnership dealings; in those beyond, the individual partners making the contract are bound, not the other partners. But corporations, which are creations of law, are, when the seal is properly affixed, bound just as individuals are by their own contracts, and as much as all the members of a partnership would be by a contract in which all concurred."

§ 1023. *Sutton's Hospital Case*. — The only ancient authority cited in support of this opinion is a passage from the report of the *Sutton's Hospital Case*.¹ That case involved a charter granted by King James I incorporating the governors of Sutton's Hospital. The charter contained a clause attempting "to restrain them from aliening or demising but in a certain form." As to this provision, the following language was used: "That is an ordinance testifying the king's desire, but it is but a precept and doth not bind in law."² The remark is quite irrelevant to the actual questions before the court, and one is left in some doubt whether it is not to be deemed a mere note or gloss of the reporter. At all events, the passage quoted can hardly be deemed sufficient authority to support the view that *ultra vires* contracts of corporations chartered by the crown are binding at common law. The point is rather that the attempted limitation is one which the crown had no right to impose. The power of alienation for all the purposes of the incorporation is attached to all corporations by the common law; and hence the king could not restrict this power. It was as though an American special act of incorporation should attempt to deny to the corporation some power conferred upon all corporations by the Constitution. Nothing in the case indicates that a contract wholly beyond the scope of the purposes of the charter would have been held binding.

§ 1024. **Cases tending to show that Chartered Corporation is not bound by Ultra Vires Contracts.** — It has been held that a member of a corporation created by royal charter has the same right to enjoin performance of an act which by the charter is forbidden and declared to be a cause of forfeiture, as if the corporation had been incorporated by special act of parliament or under a general law.³ So, where a corporation had been chartered by the crown for the purpose of trading in copper, it was held that the corporation could not maintain an action of assumpsit on a parol contract for sale of iron.⁴ The court

Cf. *Lewis v. Mayor, etc. of Rochester*, 9 C. B., n. s., 401, 426-427 (per Byles, J.). cause for revocation of the charter is a modern deduction which finds no support in Coke's report.

¹ *Sutton's Hospital Case*, 10 Co. 1.

² *Rendall v. Crystal Palace Co.*,

³ *Sutton's Hospital Case*, 10 Co. 1.

⁴ K. & J. 326.

31. The doctrine that the violation of such a precept would be sufficient ⁴ *Copper Miners' Co. v. Fox* (1851), 16 Q. B. 229; 15 Jur. 703.

conceded that if the subject of the contract had been within the scope of the company's business as defined in its charter, the absence of a seal would not have rendered the contract unenforceable even according to the English rule;¹ for the corporation was a trading company.² The point of the decision is, that the exception, in the case of trading companies, to the rule requiring contracts of corporations to be under seal is confined to contracts of trading corporations within the scope of the business defined by the charter, and is not extended to parol contracts entered into within the scope of an *ultra vires* trading business conducted by the corporation. Lord Campbell, in delivering the judgment of the court, added this caution: "It is unnecessary for us to consider whether the company could sue or be sued in this case, even if the contract had been by deed."³ The case certainly lends no support to the view that *ultra vires* contracts of royal-charter corporations are binding, but so far as it goes tends in the opposite direction.⁴

§ 1025. **Difficulty of explaining Rise of Doctrine of Ultra Vires in America upon contrary Supposition.** — If *ultra vires* contracts of royal-charter corporations were binding at common law, the universal and apparently spontaneous growth in America of the doctrine that *ultra vires* contracts of all kinds of corporations are void is very difficult to explain.⁵ It is true, American

¹ As to which see *supra*, § 473.

² "Had the subject matter of this contract been copper, or if it had been shown in any way to be incidental or ancillary to carrying on the business of copper miners, the contract would have been binding although not under seal; for where a trading company is created by charter, while acting within the scope of the charter, it may enter into the commercial contracts usual in such a business in the usual manner." 16 Q. B. 236, per Lord Campbell.

³ 16 Q. B. 237.

⁴ The references scattered through the report to a supposed distinction between executed and executory contracts do not refer to the distinction which obtains in America, although not in England,

between executed and executory *ultra vires* contracts but rather to the doctrine, once prevalent and, after a period of disfavor, lately revived, that the English rule requiring contracts of a corporation to be under seal does not invalidate an executed parol contract. See Lindley on Companies, 6th ed., 270, and *Lawford v. Billericay Rural District Council* (1903), 1 K. B. 772.

⁵ For early American cases in which this doctrine was enunciated, see *Pennsylvania, etc. Nav. Co. v. Dandridge* (1836), 8 G. & J. 248; 29 Am. Dec. 543 (party to an *ultra vires* contract no remedy against the corporation although he had fully performed his part); *New York Firemen Ins. Co. v. Eley* (1824), 2 Cow. (N. Y.) 678 (corporation discounting a note when so to do was beyond the

corporations are created under special act or under a general law, as distinguished from a royal charter; but this distinction has never been emphasized by our courts.¹ On the contrary, they have always assumed that the same rules of law with respect to *ultra vires* contracts govern our statutory corporations as applied to the old common-law corporations. If, at the time of the American Revolution, the view had been prevalent that *ultra vires* contracts of royal-charter corporations were binding, assuredly a contrary doctrine would not have been applied to the statutory American corporations — most certainly not without a word of protest or dissent and without any distinction drawn by the courts between the two classes of corporations.

§ 1026. **Late Development of Doctrine of Ultra Vires.** — Lest, however, too much weight be given to the considerations adduced in the last paragraph, it is but proper to advert to the surprisingly late development of the law relating to *ultra vires* contracts of corporations.² Attention has already been called to the extremely brief and commonplace remark with which Blackstone dismisses the whole subject of *ultra vires*.³ Chancellor Kent in his Commentaries is scarcely more explicit.⁴ Even Angell and Ames, whose work was for so many years the standard treatise in America upon the law of corporations, assume rather than

purposes for which it was created no remedy on the note — a decision with which an earlier case, *Utica Ins. Co. v. Scott*, 19 Johns. (N. Y.) 1, should be compared); *Life & Fire Ins. Co. v. Mechanic Fire Ins. Co.* (1831), 7 Wend. (N. Y.) 31 (no recovery allowed for *ultra vires* loan); *Berlin v. New Britain* (1832), 9 Conn. 175, 180; *New York Firemen Ins. Co. v. Eley* (1825), 5 Conn. 560; 13 Am. Dec. 100 (corporation discounting note without authority no remedy on the note); *North River Ins. Co. v. Lawrence* (1830), 3 Wend. (N. Y.) 482 (corporation discounting note without authority not allowed to maintain action as endorsee).

¹ See *Head v. Providence Ins. Co.*, 2 Cranch 127, 167, where Marshall, C. J., said: "Without ascribing to

this body, which, in its corporate capacity, is the mere creature of the act to which it owes its existence, all the qualities and *disabilities* annexed by the common law to ancient institutions of this sort, it may correctly be said to be precisely what the incorporating act has made it, to derive all its powers from that act, and to be capable of exerting its faculties only in the manner which that act authorizes."

² Cf. 9 Harv. L. Rev. 255, where Mr. George Wharton Pepper, in an able article, demolishes Judge Thompson's theory of the existence of an "ancient doctrine" of extreme severity upon the subject of *ultra vires*.

³ Supra, § 1022.

⁴ 2 Kent's Comm. 291, 292.

state the doctrine that *ultra vires* contracts are unenforceable.¹ The doctrine of *ultra vires* did not begin to assume definite shape in America until the second or third decade of the nineteenth century.² Nevertheless, the American law began to crystallize before the English decisions in respect to corporations created by special act or formed under general laws,³ so that the American decisions could not have been suggested by the English rule as to such corporations.

§ 1027-§ 1031. *English Rule as to Contracts of Modern Statutory Corporations.*

§ 1027. **Ultra Vires Contracts of Statutory Corporations Void.** — Whatever may be or may have been the doctrine of the common law of England with respect to the validity *inter partes* of *ultra vires* contracts of royal charter corporations, the English rule with respect to companies incorporated by special act or under general laws is now settled upon a logical and, in comparison with the uncertainties of the American law, upon a firm basis of extreme severity. As to companies incorporated by special act, the English law was established in 1851 by a decision of the Court of Common Pleas that contracts in excess of the powers of the company as defined in the act of incorporation, even though in themselves harmless, are nevertheless to be deemed prohibited by the act, and therefore illegal and void;⁴ and the law as thus laid down has ever since been adhered to by the English courts.⁵ As to corporations formed under the Companies Acts, serious diversity of opinion existed among the English lawyers and judges. Some argued that since the powers

¹ Angell & Ames on Corps., 2d ed., chap. VIII, § 12. *Mytton v. Gilbert* (1787), 2 T. R. 169 (unauthorized mortgage by statutory trustees of a turnpike held to convey no title sufficient to enable mortgagee to maintain ejectment against the mortgagor).

² See supra, p. 826 n. 5.

³ For which see infra, § 1027 et seq.

⁴ *East Anglian Ry. Co. v. Eastern Counties Ry. Co.* (1851), 11 C. B. 775. The earliest trace of this doctrine seems to be a dictum, or to speak more accurately, a query of Bayley, J., in *Broughton v. Manchester Water-Works Co.* (1819), 3 B. & Ald. 1, 8. See also *Fairtitle ex dem.*

⁵ *Macgregor v. Official Manager of the Deal, etc. Ry. Co.* (1852), 22 L. J. Q. B. 69 (in the Exchequer Chamber); *Shrewsbury, etc. Ry. Co. v. Northwestern Ry. Co.* (1857), 6 H. L. Cas. 113.

of such corporations are not defined by act of parliament but are dependent upon the terms of a mere contract or convention, namely, the memorandum of association, therefore no statutory prohibition of contracts in excess of those powers could be discovered, so that the reason for holding such contracts to be unenforceable failed. But the House of Lords discerned in the Companies Acts a legislative intention that a company incorporated under them should keep within its powers as limited by its memorandum of association, and hence held that a contract in excess of those powers was as invalid as if the memorandum of association were a special act of incorporation.¹ The case was held to be one of statutory limited capacity, so that contracts beyond that capacity could not bind the corporation.

§ 1028. **Consent of Shareholders imparts no Vitality to Contract.** — The English courts carry out this theory with severe consistency. *Ultra vires* contracts, they hold, are, so far as the corporation is concerned, wholly void — mere nullities. The case is not altered though the contract was authorized or ratified by every shareholder. Not even the unanimous consent of every member will make the contract binding upon the corporate assets,² or enable the corporation as a legal entity to maintain an action thereon.

§ 1029. **Judgment by Consent on Contract Invalid.** — Not even a judgment, rendered against the company by consent, upon an *ultra vires* contract is binding upon the corporation.³ “A company cannot do what is beyond its legal powers by simply going into court and consenting to a decree which orders that the thing shall be done. If the legality of the act is one of the points substantially in dispute, that may be a fair subject of compromise in court, like any other disputed matter.”⁴

§ 1030. **Execution of Contract does not validate it.** — Furthermore, the contract acquires no validity by being executed. Title will not pass under it;⁵ and in legal contemplation the rights of all parties are, as nearly as may be, as if no contract

¹ *Ashbury Ry., etc. Co. v. Riche*, L. R. 7 H. L. 653.

² *East Anglian Rys. Co. v. Eastern Counties Ry. Co.*, 11 C. B. 775.

³ *Great North-West Central Ry. Co. v. Charlebois* (1899), A. C. 114. Compare *infra*, § 1044.

⁴ (1899) A. C. 124, per Lord Hobhouse.

⁵ Cf. *Fairtitle ex dem. Mytton v. Gilbert* (1787), 2 T. R. 169 (stated *supra*, p. 828, n. 4.).

had been made.¹ The contract is like the contract of a married woman at common law. The English cases have not, with any degree of clearness or certainty, adopted the American doctrine that executed *ultra vires* contracts will not be disturbed or ripped open but that, as in cases of mere illegality, the law will recognize whatever is done under the contract as a *fait accompli*, and will leave the parties where it finds them. To be sure, a decision of the Privy Council is sometimes cited to show that executed *ultra vires* contracts will be deemed effective and that title will pass under such contracts. In that case, an Australian bank which by its charter was prohibited from lending on the security of merchandise was held by the Judicial Committee to be entitled to maintain an action of trover for wool hypothecated to it in violation of the prohibition in the charter.² The case, however, was decided before the decision of the House of Lords in *Ashbury Ry., etc. Co. v. Riche*,³ which established the English law of *ultra vires*; and, moreover, the bank seems to have been incorporated by royal charter, instead of under a special act or general enabling law or companies act.

Since, therefore, according to the English doctrine, an *ultra vires* contract even though fully executed on both sides is nevertheless void, *a fortiori* when an *ultra vires* contract has been performed on one side, the opposite party cannot be compelled to perform.⁴ Not only so, but the opposite party is, perhaps, under no quasi-contractual obligation to make compensation for benefits which may have been received from such partial execution of the contract.⁵

¹ Cf. *Ex parte Liquidators of British Nation Life Ass. Ass'n*, 8 Ch. D. 679, 707 (holding that a corporation which purchases shares in another company, being without corporate capacity to acquire them, does not undergo any liability as shareholder).

² *Ayers v. South Australian Banking Co.*, L. R. 3 P. C. 548.

Cf. *Durham Bldg. Soc.*, 12 Eq. 516; *National Bldg. Soc.*, 5 Ch. 309.

See also *Webb v. Shropshire Rys. Co.* (1893), 3 Ch. 307, 321, 331; *Trevor v. Whitworth*, 12 A. C. 409, 439-440 (where *Dronfield Silkstone*

Coal Co., 17 Ch. D. 76, was distinguished on the ground that in that case the court was dealing with an executed *ultra vires* contract, while in the case before the House the contract was still executory).

³ *Ashbury Ry., etc. Co. v. Riche*, L. R. 7 H. L. 653.

⁴ *Ashbury Ry., etc. Co. v. Riche*, L. R. 7 H. L. 653; *Phænix Life Ass. Co.*, 2 Johns. & H. 441.

⁵ See cases *infra*, § 1031, as to *ultra vires* loans. But cf. *Phænix Life Ass. Co.*, 2 Johns. & H. 441 (where a corporation which had

§ 1031. **Ultra Vires Loans.** — All these principles of the English law of *ultra vires* have found their most frequent and most striking application in cases relating to *ultra vires* loans. What are the rights of a person who lends money to a corporation which has no power to borrow? The contract being void, he cannot recover the amount as a debt.¹ On the other hand, inasmuch as the contract is void, the money is still the money of the lender; and hence if it remains *in specie* in the company's hands the lender may retake or recover it,² or if the money has been invested by the company and can be traced and distinguished, it would seem that upon the same principles the lender might claim the investment.³ If the money is used in paying off valid debts of the company, the court will look at the substance rather than the form of the transaction, and seeing that to the extent the money has been so applied there has been no real increase of indebtedness will permit a recovery to the extent of such application, whether the valid claims so paid off were contracted before the *ultra vires* loan⁴ or after it;⁵ and in such a case interest may be recovered on the amounts so applied.⁶ Moreover, to the extent that moneys advanced were employed in defraying legitimate obligations of the company, the lender is entitled to the benefit of security given by the corporation for repayment of the *ultra vires* loan.⁷ In the earlier cases, this doctrine was placed upon the ground that the lender was subrogated to the rights of the persons whose

executed *ultra vires* contracts of insurance was held liable for a return of the premiums).

¹ Cf. *Chapleo v. Brunswick Bldg. Soc.*, 6 Q. B. D. 696 (a case of an unincorporated company). But as to the rights of a *bona fide* purchaser of a negotiable instrument, see *Gordon v. Sea Fire Life Ass. Soc.*, 1 H. & N. 599.

² *Wrexham, etc. Ry. Co.* (1899), 1 Ch. 440, 457, per Vaughan Williams, L. J.

³ Cf. *Blackburn Bldg. Soc. v. Cunliffe, Brooks & Co.*, 29 Ch. D. 902; *Neath Bldg. Soc. v. Luce*, 43 Ch. D. 158.

But see *Durham Bldg. Soc.*, 12

Eq. 516, 520-521 (headnote inadequate).

⁴ *Bagnalstown, etc. Ry. Co., Ir.* Rep. 4 Eq. 505; *Wenlock v. River Dee Co.*, 19 Q. B. D. 155.

⁵ *Wenlock v. River Dee Co.*, 19 Q. B. D. 155.

⁶ *Troup's Case*, 29 Beav. 353.

⁷ *Blackburn Bldg. Soc. v. Cunliffe, Brooks & Co.*, 22 Ch. D. 61. The case was taken to the House of Lords, but this particular question did not come before that appellate tribunal. *Cunliffe, Brooks & Co. v. Blackburn Bldg. Soc.*, 9 A. C. 857.

Cf. *National Bldg. Soc.*, 5 Ch.

claims were discharged with his money.¹ This theory comported very well with the principle that the *ultra vires* contract was wholly void; but if it were logically accepted the lender would be subrogated to the benefit of any security which had been given to the creditors whose claims were paid off, so that the lender might in that way stand in a better position than if his contract of loan had been *intra vires*. Such a result was so shocking to the English sense of fitness, that the courts refused to carry the doctrine of subrogation to that extent; and held that the lender's right of recovery should be based not upon subrogation but upon quasi-contractual grounds—upon the principle that in substance the corporation's debts had not been increased by the borrowing.² In reason and justice, it would seem that the lender in a case of an *ultra vires* loan should be allowed to recover not merely where his money was used to pay off valid claims against the company, but also where it has been used or applied for the benefit of the company's legitimate business in any other way;³ but some English decisions leave great doubt whether this result would be reached.⁴

§ 1032-§ 1047. THE RULE OF THE FEDERAL COURTS.

§ 1032. **In general.**—The rigor of these English rules of *ultra vires* is attained, probably, by no court in the United States. The nearest approach to them is the doctrine enforced by the federal courts, which therefore it behooves us next to consider.

The federal courts follow upon this subject of *ultra vires* the decisions of the supreme court of the state whose law they are enforcing;⁵ but in the absence of any settled rule enunciated by the highest state court they follow their own doctrine.⁶

¹ *Wenlock v. River Dee Co.*, 19 Q. B. D. 155; *Neath Bldg. Soc. v. Luce*, 43 Ch. D. 158.

² *Wrexham, etc. Ry. Co.* (1899), 1 Ch. 440.

But see *Neath Bldg. Soc. v. Luce*, 43 Ch. D. 158, 164.

³ See *Troup's Case*, 29 Beav. 353; *Hoare's Case*, 30 Beav. 225; *Neath Bldg. Soc. v. Luce*, 43 Ch. D. 158; *Magdalena Steam Nav. Co.*, Johnson 690.

⁴ *National Bldg. Soc.*, 5 Ch. 309; *Durham Bldg. Soc.*, 12 Eq. 516.

⁵ *Sioux City, etc. Co. v. Trust Company of North America*, 173 U. S. 99; 19 Sup. Ct. 341. It is doubtless upon this ground that one should explain the decision in *Eastern Bldg., etc. Ass'n v. Williamson*, 189 U. S. 122, 129-130 (headnote inadequate); 23 Sup. Ct. 527.

⁶ *Anglo-American Land, etc. Co. v. Lombard*, 132 Fed. 721.

Conversely, the state courts in actions by or against corporations formed under Acts of Congress must, as to those corporations, apply the federal doctrine of *ultra vires*.¹

§ 1033-§ 1041. *Fully Executed Ultra Vires Contracts.*

§ 1033. **General Principle — Fully Executed Contracts not to be ripped open.** — The widest departure of the Supreme Court from the English doctrine consists in the clear and emphatic recognition that *ultra vires* contracts when once fully executed will not be upset or ripped open by the courts. Like ordinary illegal contracts, *ultra vires* contracts will be treated as valid when performed by both parties. For example, a deed of conveyance executed in pursuance of an *ultra vires* contract will nevertheless pass title. The court will not undertake to restore the *status in quo*, but will leave the parties where it finds them. This principle is thoroughly accepted by the federal courts,² and on the surface appears simple enough. Many questions of doubt and difficulty are, however, encountered in its application.

§ 1034. **Special cases — Ultra Vires Acquisition of Shares in other Corporations.** — For instance, in one case it was said *obiter* that a corporation which, *ultra vires*, acquires shares in

¹ *First Nat. Bank v. American Nat. Bank*, 173 Mo. 153; 72 S. W. 1059; *Mapes v. Scott*, 94 Ill. 379, 384; *Merchants' Nat. Bank v. Hanson*, 33 Minn. 40 (headnote inadequate); 53 Am. Rep. 5; *Fidelity & Dep. Co. v. Nat. Bank of Commerce* (Tex. Civ. App.), 106 S. W. 782; *California Bank v. Kennedy*, 167 U. S. 362; 17 Sup. Ct. 831 (reversing the Supreme Court of California). Any decisions to the contrary in state courts, such as *First Nat. Bank v. Greenville Oil, etc. Co.* (Tex.), 60 S. W. 828; 24 Tex. Civ. App. 645; *Security Nat. Bank v. St. Croix Power Co.*, 94 N. W. 74; 117 Wisc. 211, are in conflict with the decision of the Federal Supreme Court in *California Bank v. Kennedy*, *ubi supra*.

² In addition to cases cited in succeeding notes, see *Old Colony*

Trust Co. v. City of Wichita, 123 Fed. 762; *Savings & Trust Co. v. Bear Valley Irrigation Co.*, 112 Fed. 693; *Bear Valley Land, etc. Co. v. Savings & Trust Co.*, 117 Fed. 941; *Central Trust Co. v. Western N. C. R. Co.*, 89 Fed. 24; *Peru Plow, etc. Co. v. Harker*, 144 Fed. 673; 75 C. C. A. 475 (that acceptance of assignment of claim for damages *ultra vires* of assignee company cannot be availed of by wrongdoer); *Mapes v. Scott*, 94 Ill. 379 (as to national banks); *Atlantic & Pac. Tel. Co. v. Union Pac. Ry. Co.*, 1 Fed. 745 (bill to enjoin other party from retaking possession of property transferred in pursuance of *ultra vires* contract).

For a case where a federal judge seems not to have borne this principle in mind, see *Cumberland Tel., etc. Co. v. Evansville*, 127 Fed. 187.

another company is nevertheless subjected to all the liabilities of a shareholder;¹ but in later cases, where the point has been squarely raised, a contrary rule has been adopted.² Moreover, in such cases, the transferor remains subject to the liabilities of a shareholder as if no transfer had been executed,³ and the transferee corporation is not taxable as a shareholder even though it is receiving dividends on the shares.⁴ The Circuit Court of Appeals for the Ninth Circuit has held that where a corporation makes an *ultra vires* subscription to shares in a building association for the purpose of obtaining a loan from the latter organization, the borrowing company cannot maintain a bill to set aside the transaction, but on the contrary the building society may have a foreclosure of the mortgage.⁵ On the other hand, where a corporation makes an *ultra vires* agreement to transfer its property and undertaking in exchange for shares in a new corporation, the issue of the shares without delivery of the property is only part performance of the contract, and the old company on offering to surrender the shares may maintain a bill in equity to set the contract aside and to enjoin the new company from taking possession of the property.⁶

§ 1035. *Ultra Vires Partnerships*. — If the corporation enters into an *ultra vires* partnership agreement, the transaction is

¹ *National Bank v. Case*, 99 U. S. 628, 633 (semble).

Cf. *Bowman v. Foster, etc. Hardware Co.*, 94 Fed. 592 (as to the liability of a corporation which becomes a member of a building and loan association); *Citizens State Bank v. Hawkins*, 71 Fed. 369; 18 C. C. A. 78 (proceeding on the ground that the corporation had power to accept the shares as security for a loan, etc., so that the outward act was not improper but was rendered illegal only by the secret motive of the corporation).

² *California Bank v. Kennedy*, 167 U. S. 362; 17 Sup. Ct. 831; *Concord First Nat. Bank v. Hawkins*, 174 U. S. 364; 19 Sup. Ct. 739; *Schofield v. Goodrich Bros. Banking Co.*, 98 Fed. 271; 39 C. A. 76; *First Nat. Bank v.*

Converse, 200 U. S. 425; 26 Sup. Ct. 306.

Cf. *Merchants' Nat. Bank v. Wehrmann*, 202 U. S. 295; 26 Sup. Ct. 613 (where the shares were in an unincorporated association).

Cf. also *supra*, p. 830, n. 1.

³ *Anglo-American Land, etc. Co. v. Lombard*, 132 Fed. 721, 736-738.

⁴ *Shaw v. National German-American Bank*, 132 Fed. 658; 65 C. C. A. 620, affirmed short in 199 U. S. 603; 26 Sup. Ct. 750.

⁵ *U. S. Savings & Loan Co. v. Convent of St. Rose*, 133 Fed. 354; 66 C. C. A. 416 (note that some expressions in this opinion are in conflict with the law as laid down by the Supreme Court in cases cited *infra*, § 1043, § 1044).

⁶ *McCutcheon v. Merz Capsule Co.*, 71 Fed. 787; 19 C. C. A. 108; 31 L. R. A. 415.

deemed executed so far as any funds contributed to the firm are concerned. As to the assets of the firm, the rights of the parties will be the same as if the contract of partnership were valid. Hence, if the company makes a loan or advance to the firm, the claim will not be admitted to proof in bankruptcy against the firm assets in competition with firm creditors.¹ On the other hand, the corporation is not subject to the liability of a partner.²

§ 1036. *Ultra Vires Mortgages.* — The principle that executed *ultra vires* contracts are effective operates to validate an *ultra vires* mortgage. Hence, a mortgage to a corporation which in accepting it was acting *ultra vires* will nevertheless entitle the mortgagee to the surplus proceeds of a sale under a prior mortgage;³ or the mortgagee may enforce his own security by foreclosure or by the exercise of a power of sale given in the mortgage.⁴ So, a mortgage by a corporation which has no power to make it is nevertheless valid against other creditors of the mortgagor.⁵ These cases show that so far as the subject in hand is concerned a mortgage is to be deemed not an executory contract but a species of conveyance.

§ 1037. *Passage of Equitable Title under Ultra Vires Contract.* — On the other hand, the passing of mere equitable title will not be deemed such an execution of an *ultra vires* contract as to enable the intended grantee to enforce the ordinary remedies of an equitable owner for getting in the legal title.⁶ For instance, it is said that upon the making of a contract for the

¹ *Wallerstein v. Ervin*, 112 Fed. 124; 50 C. C. A. 129.

² *Merchants' Nat. Bank v. Wehrmann*, 202 U. S. 295; 26 Sup. Ct. 613.

³ *National Bank v. Whitney*, 103 U. S. 99.

⁴ *National Bank v. Matthews*, 98 U. S. 621.

Cf. *National Bank of Xenia v. Stewart*, 107 U. S. 676; 2 Sup. Ct. 778; *U. S. Savings & Loan Co. v. Convent of St. Rose*, 133 Fed. 354; 66 C. C. A. 416; *Schuyler Nat. Bank v. Gadsden*, 191 U. S. 451; 24 Sup. Ct. 129 (where the mortgage was made to an agent of the corporation as its representative or trustee);

Kansas Valley Nat. Bank v. Rowell, 2 Dillon 371 (a case which is in conflict with later decisions of the Supreme Court cited above).

⁵ *Jones v. Guaranty & Indemnity Co.*, 101 U. S. 622.

Cf. *Bowman v. Foster, etc. Hardware Co.*, 94 Fed. 592.

But see *First Nat. Bank v. Winchester*, 119 Ala. 168; 24 So. 351; 72 Am. St. Rep. 904 (where it was said that a mortgage to secure an *ultra vires* guarantee will not pass legal title).

⁶ But see *Schuyler Nat. Bank v. Gadsden*, 191 U. S. 451; 24 Sup. Ct.

sale of real estate the equitable title vests in the vendee; but the passing of this equitable title is not deemed an execution of the contract, and will not enable the vendee, if it be a corporation having no power to make such a contract, to maintain a bill for specific performance.¹

§ 1038. *Ultra Vires Trusts*. — On the other hand, the fact that a corporation has no power to act as trustee will not prevent a court of equity from compelling it to carry out a trust which it has assumed.² In such a case, if the trust be an active one, a chancellor should doubtless appoint a new trustee.

§ 1039. *Ultra Vires Leases*. — *A priori*, one might suppose that a lease, at any rate when followed by a transfer of possession, would be deemed an executed contract quite as truly as a mortgage; but the federal courts, which have often had to deal with the question in connection with railway leases, have not reached this conclusion.³ On the contrary, they regard a lease reserving an annual rental as unexecuted, except for the time during which the lessee is actually in possession paying rent. Hence, a lessee corporation under an *ultra vires* lease, which throws up the lease during the term, and abandons possession, is not liable for subsequently accruing rent.⁴ So, where a lessor corporation exercises an option of terminating the demise, which was *ultra vires*, the company cannot be compelled to carry out an agreement, also contained in the lease, for the payment to the lessee of the value of the residue of the term.⁵ On the other hand, with doubtful consistency, the Supreme Court has held that a lease is so far an executed contract that a court of equity will not assist a lessor, who has repudiated the lease as *ultra vires*, in retaking possession of the demised property.⁶ This last decision is, however, certainly difficult to reconcile with a later case which decides that where at the time of the repudiation of an

¹ *Case v. Kelly*, 133 U. S. 21; 10 Sup. Ct. 216.

² *Central R. R., etc. Co. v. Farmers' L. & T. Co.*, 116 Fed. 700; *Central R. R., etc. Co. v. Farmers' L. & T. Co.*, 114 Fed. 263; 52 C. C. A. 149.

³ Cf., however, *Blair v. City of Chicago*, 201 U. S. 400, 450-451; 26 Sup. Ct. 427; *Rogers v. Nashville, etc. Ry. Co.*, 91 Fed. 299; 33 C. C. A. 517.

⁴ *Oregon Ry. Co. v. Oregonian Ry. Co.*, 130 U. S. 1, 37-38; 9 Sup. Ct. 409.

But see *Brown v. Schleier*, 194 U. S. 18 (headnote inadequate); 24 Sup. Ct. 558.

⁵ *Thomas v. Railroad Co.*, 101 U. S. 71.

⁶ *St. Louis, etc. R. R. Co. v. Terre Haute, etc. R. R. Co.*, 145 U. S. 393; 12 Sup. Ct. 953.

ultra vires lease the leased property has ceased to exist *in specie*, the lessor may recover in equity the reasonable value of the property at the time of the repudiation.¹ In a case in a circuit court where the consideration for an *ultra vires* lease consisted in a transfer of stock in the lessee company, it was held that the lessee might enjoin the lessor from retaking possession of the leased property.² This case is distinguishable from other decisions in that the consideration was paid once for all upon the execution of the lease and did not consist in a periodic rental.

§ 1040. *Ultra Vires Bonds*. — Where bonds of a corporation are issued in exchange for a promissory note which the company has no corporate capacity to hold, the Circuit Court of Appeals for the Second Circuit held that the bonds so issued were void.³ It must be remembered, however, that where a corporation has power to issue negotiable bonds for any purpose, bonds issued for a different or *ultra vires* purpose will nevertheless be valid in the hands of *bona fide* purchasers who have no notice of the circumstances of the issue.⁴

§ 1041. *Devise, Legacy, or Conveyance to Corporation in Excess of Amount of Property which it is authorized to hold*. — The United States Supreme Court holds that a devise, legacy, or conveyance to a corporation in excess of the amount which by its charter it is authorized to hold, is in the nature of an executed contract, and is therefore good *inter partes*.⁵ This result is not a little remarkable, because the opposite conclusion has been reached by some courts which in other respects adopt a much looser rule in regard to *ultra vires* contracts than the Federal Supreme Court.⁶ *A fortiori*, a deed conveying land to a corporation will pass a good title notwithstanding the fact that the company may have intended to use it for an *ultra vires* purpose.⁷

¹ *Pullman's Palace Car Co. v. Central Transportation Co.*, 171 U. S. 138; 18 Sup. Ct. 808.

² *Atlantic & Pac. Tel. Co. v. Union Pac. Ry. Co.*, 1 Fed 745.

³ *Waterloo Organ Co.*, 134 Fed. 341 (decided under a statute forbidding bonds to be issued "except for money, labor, or property actually received for the use and lawful purposes" of the corporation).

⁴ *Infra*, § 1061 and § 1702-§ 1705.

⁵ *Jones v. Habersham*, 107 U. S. 174, 185-188; 2 Sup. Ct. 336; *Blair v. City of Chicago*, 201 U. S. 400, 450-451; 26 Sup. Ct. 427; *Christian Union v. Yount*, 101 U. S. 352, 361.

⁶ *Infra*, § 1050.

⁷ *Cowell v. Springs Co.*, 100 U. S. 55. Cf. *Christian Union v. Yount*, 101 U. S. 352, 361.

§ 1042-§ 1047. *Contracts which remain in Part Executory.*

§ 1042. **No Right of Action on Contract even by a Party who has fully performed his Side.** — While the federal courts diverge from the English authorities in recognizing the validity of executed *ultra vires* contracts, in all other respects they approximate very closely to the rigorous English rules. From a comparatively early date the Supreme Court has held that although one party to an *ultra vires* contract has fully performed his side, and although the other party has received all the benefit he would derive from a complete execution of the agreement, yet the party who has performed has no remedy on the contract against the party who has not.¹ Thus, where a company incorporated exclusively for railway purposes purchases a steamboat and gives its note for the purchase price, a holder with notice of these facts cannot recover against the company on the note.² So, in the case of a lease which is *ultra vires* of the lessee, the lessor cannot recover the stipulated rental even for the time during which the lessee has been in possession enjoying the full benefits of the contract;³ and the same rule holds where the lease is

¹ In addition to cases cited *infra*, see *Waterloo Organ Co.*, 134 Fed. 341; *S. P. Smith Lumber Co.*, 132 Fed. 620 (headnote inadequate); *De La Vergne, etc. Co. v. German Savings Inst.*, 175 U. S. 40; 20 Sup. Ct. 20; *Bowen v. Needles Nat. Bank*, 94 Fed. 925; 36 C. C. A. 553; *Quinby v. Consumers' Gas Trust Co.*, 140 Fed. 362; *Humboldt Mining Co. v. Am. Mfg., etc. Co.*, 62 Fed. 356; 10 C. C. A. 415 (*ultra vires* guaranty); *Evans v. Johnson*, 149 Fed. 978; 79 C. C. A. 488 (applying law of Minnesota to *ultra vires* guaranty); *Vanderveer v. Asbury Park, etc. Ry. Co.*, 82 Fed. 355.

But see *Hitchcock v. Galveston*, 96 U. S. 342, 351 (headnote inadequate); *U. S. Savings & Loan Co. v. Convent of St. Rose*, 133 Fed. 354; 66 C. C. A. 416; *Maxwell v. Akin*, 89 Fed. 178; *Lyon v. First Nat. Bank*, 85 Fed. 120; 29 C. C. A. 45;

Poole v. West Point Butter, etc. Ass'n, 30 Fed. 513; *Sioux City Terminal, etc. Co. v. Trust Co. of North America*, 52 Fed. 191; *Mutual Life Ins. Co. v. Wilcox*, 8 Biss. 203; *Lyon Potter & Co. v. First Nat. Bank*, 85 Fed. 120, 122; 29 C. C. A. 45; *Holt v. Winfield Bank*, 25 Fed. 812 (a dictum of Brewer, J.); *Eastern Bldg. Ass'n v. Williamson*, 189 U. S. 122, 129-130; 23 Sup. Ct. 527 (doubtless explainable on the ground that the court was applying the law of New York).

² *Pearce v. Madison, etc. R. R. Co.*, 21 How. 441.

³ *Pennsylvania R. R. Co. v. St. Louis, etc. R. R. Co.*, 118 U. S. 290; 6 Sup. Ct. 1094; *McCormick v. Market Bank*, 165 U. S. 538; 17 Sup. Ct. 433; *Cox v. Terre Haute, etc. R. R. Co.*, 133 Fed. 371; 66 C. C. A. 433.

Cf. *East St. Louis Connecting Ry. Co. v. Jarvis*, 92 Fed. 735.

ultra vires of the lessor company instead of the lessee.¹ *A fortiori*, an *ultra vires* guarantee by a corporation cannot be enforced against it.² Moreover, as already stated, a corporation which enters into an *ultra vires* partnership arrangement is not liable as partner.³ Of course, the federal courts hold that an *ultra vires* contract which was repudiated by one party or the other while remaining wholly executory will not support an action.⁴

§ 1043. *Over-emphatic Statement of this Principle by Supreme Court.* — The principle on which these conclusions are based by the Supreme Court has been set forth by Mr. Justice Gray in language which has become almost classic. "A contract of a corporation," said that learned judge, "which is *ultra vires*, in the proper sense, that is to say, outside the object of its creation as defined in the law of its organization, and therefore beyond the powers conferred upon it by the legislature, is not voidable only, but wholly void, and of no legal effect. The objection to the contract is, not merely that the corporation ought not to have made it, but that it could not make it. The contract cannot be ratified by either party because it could not have been authorized by either. No performance on either side can give the unlawful contract any validity, or be the foundation of any right of action upon it."⁵ Pronouncements almost equally forcible might be culled from other opinions of the same court, delivered some by the same judge and others by other judges. Such statements, however, standing alone, are certainly too sweeping, and are not borne out by the decisions of the Supreme Court. For instance, the statement that "no performance on either side can give the unlawful contract any validity," taken by itself, might well induce the belief that the Supreme Court would hold an executed *ultra vires* contract or conveyance to be void, and to pass no title; but, as shown above, such is not the case. Such dicta should be restricted in their bearing to the particular point actually decided, and be taken as merely emphatic statements

¹ *Central Transportation Co. v. Mann*, 202 U. S. 295; 26 Sup. Ct. *Pullman's, etc. Co.*, 139 U. S. 24; 613.

11 Sup. Ct. 478.

² *Pennsylvania R. R. Co. v. St.* 812.

Louis, etc. R. R. Co., 118 U. S. 290;

6 Sup. Ct. 1094.

⁴ *Holt v. Winfield Bank*, 25 Fed.

⁵ *Central Transportation Co. v.*

Pullman's, etc. Co., 139 U. S. 24,

³ *Merchants' Nat. Bank v. Wehr-* 59-60; 11 Sup. Ct. 478.

of the doctrine, which is rigorously adhered to by the Supreme Court, that even complete performance by one party to an *ultra vires* contract of his side thereof will not entitle him to maintain an action on the contract against the other party for non-performance of his side.

§ 1044. **Effect of Judgment on Ultra Vires Contract.** — Even a judgment against a corporation for breach of an *ultra vires* contract, at any rate a judgment by consent or by default, will be treated by the federal courts as so far invalid as to be unenforceable against a shareholder.¹

§ 1045. **Remedy Quasi Ex Contractu to recover for Benefits received under Ultra Vires Contract.** — Whilst the federal courts rigidly adhere to this rule that *ultra vires* contracts executed on one side will not support an action against the opposite party, yet since they repudiate the English doctrine that *ultra vires* contracts are pure nullities, and adopt the view that whatever is actually done under an *ultra vires* contract stands an accomplished fact, they cannot alleviate the hardship of the rule by the English expedient of permitting a person who has parted with property or money on the faith of an *ultra vires* contract to follow and retake the property or money as if no contract had been made. Some device had to be adopted to relieve the intolerable harshness of the rule. Accordingly, the Supreme Court in a number of cases threw out rather tentative suggestions that a party to an *ultra vires* contract who has performed his side in whole or in part is entitled upon the repudiation of the agreement by the other party to recover, not upon the express contract, but *quasi ex contractu*, the reasonable value of the property which he has parted with on the faith of the agreement;² and these dicta were at last followed by a direct decision.³ On the other hand, in a case relating to an *ultra*

¹ *Ward v. Joslin*, 186 U. S. 142; *Richmond*, 12 Wall. 349, 354-356. 22 Sup. Ct. 807. Compare *supra*, § 1029. But see *Illinois, etc. Bank v. Pacific Ry. Co.*, 117 Cal. 332, 342; 49 Pac. 197 (where a judgment not appealed from was held conclusive on a question of *ultra vires*).

² *Central Transportation Co. v. Pullman's, etc. Co.*, 139 U. S. 24, 60; 11 Sup. Ct. 478; *Thomas v. City of*

Richmond, 12 Wall. 349, 354-356. See also *De La Vergne, etc. Co. v. German Sav. Inst.*, 175 U. S. 40; 20 Sup. Ct. 20.

³ *Pullman's Palace Car Co. v. Central Transportation Co.*, 171 U. S. 138; 18 Sup. Ct. 808. Accord: *New Castle Northern Ry. Co. v. Simpson*, 21 Fed. 533; *Richmond Guano Co. v. Farmers' Cotton, etc. Co.*, 126 Fed. 712; 61 C. C. A. 630

vires lease, Mr. Justice Miller, speaking for the court, said that the question whether the lessor could recover from the lessee corporation upon a *quantum meruit* for the use of the property during the time possession was held under the void lease "admits of doubt."¹ Moreover, as stated above, the lessor who repudiates an *ultra vires* lease cannot have the aid of a federal court of equity to recover the leased property from the lessee;² and this decision seems inconsistent in principle with the doctrine that recovery can be had *quantum meruit* for property parted with on the faith of an *ultra vires* contract. For if recovery can be had for the use of the property, *a fortiori*, the property *in specie* should be recoverable upon the termination of the *ultra vires* lease.

§ 1046. *Logan County National Bank v. Townsend*, 139 U. S. 67. — A case in the Supreme Court which is difficult to reconcile with other decisions of that tribunal is *Logan County National Bank v. Townsend*.³ There, a national bank entered into a speculative contract, which was assumed to be *ultra vires*, whereby the bank purchased certain bonds in consideration of a cash payment and also of a promise to restore the bonds to the vendor on demand upon his repaying the sum paid by the bank. The bonds having increased in value, the vendor called upon the bank to perform its promise to retransfer the bonds, and upon its refusal brought suit for damages. The court sustained a judgment in favor of the plaintiff for the difference between the market value of the bonds at the time of the demand and the amount paid by the bank for them. This result, it will be observed, is the same that would have been reached if the contract of the bank had been valid and enforceable. The conclusion was sought to be justified on the ground that recovery

(note the forcible dissenting opinion); *Emmerling v. First Nat. Bank*, 97 Fed. 739; 38 C. C. A. 399; *Manville v. Belden Mining Co.*, 17 Fed. 425.

See also *Aldrich v. Chemical Nat. Bank*, 176 U. S. 618; 20 Sup. Ct. 498; *Appleton v. Citizens' Nat. Bank*, 190 N. Y. 418; 83 N. E. 470 (purporting to apply federal law and stated, *infra*, p. 856, n.).

¹ *Pennsylvania R. R. Co. v. St.*

Louis, etc. R. R. Co., 118 U. S. 290, 318; 6 Sup. Ct. 1094.

² *St. Louis, etc. R. R. Co. v. Terre Haute, etc. R. R. Co.*, 145 U. S. 393; 12 Sup. Ct. 953.

But see *Pullman's Palace Car Co. v. Central Transportation Co.*, 171 U. S. 138; 18 Sup. Ct. 808.

See *supra*, § 1039.

³ *Logan County Nat. Bank v. Townsend*, 139 U. S. 67; 11 Sup. Ct.

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was allowed not upon, but in disaffirmance of, the *ultra vires* contract; inasmuch as, the contract being void, the bonds remained the property of the vendor subject to a lien of the bank for the amount paid by it. This theory is difficult to sustain on any view of *ultra vires* contracts. According to the English doctrine that *ultra vires* contracts are always and altogether void, the title to the bonds might remain in the vendor who, after the refusal of the bank to return them, might maintain an action for conversion against the bank and recover the value of the bonds at the time of the demand and refusal; and perhaps the bank might be allowed a counter-claim against the vendor for the amount paid him for the bonds. But upon what theory could this counter-claim be secured by a lien upon the bonds? Moreover, as will be remembered, the English doctrine has been repeatedly repudiated by the Supreme Court in cases holding that fully executed *ultra vires* contracts will be allowed to stand. On the other hand, the decision in *Logan County National Bank v. Townsend* cannot readily be sustained on the theory of a quasi-contractual obligation to pay for benefits received under a partly executed *ultra vires* contract; for on that theory it would seem that the measure of damages would be the difference between the amount paid by the bank for the bonds and their fair market value at the time of the transfer to the bank, and not the difference between the amount paid by the bank and the market value of the bonds at the time of the refusal of the bank to restore them. Upon the whole, the decision stands as a monument to the inherent difficulties of the subject and to the fact that not even the decisions of our highest court in dealing with the law of *ultra vires* are always altogether clear and harmonious.

§ 1047. **Bill in Equity for Rescission of Ultra Vires Contract remaining partly Executory.** — In one federal case it was held that a bill in equity will lie by a corporation which has entered into an *ultra vires* contract for a rescission of the agreement so long as it remains in part executory.¹ So, where one party to an *ultra vires* contract has fully performed his part, but has not received the property which was to be transferred as the consideration, the other party to the contract may maintain a bill in

¹ *New Castle, etc. Ry. Co. v. Simpson*, 21 Fed. 533.

equity to set aside the contract and enjoin the first party from taking possession of the property which was to be transferred.¹ This same principle has been applied to a bill to cancel negotiable bonds which were issued in pursuance of a fraudulent and *ultra vires* contract, so long as they remain in possession of the original parties.² On the other hand, the Supreme Court has held that a court of equity will not entertain a bill for recovery of property parted with under an *ultra vires* lease.³ If the principle be accepted that a bill in equity will lie for rescission of an *ultra vires* contract which remains in part executory, this decision can only be supported, it would seem, upon the doctrine that a lease should be regarded as an executed contract; and as pointed out above,⁴ if explained in that way the case would seem to be inconsistent with other decisions of the Supreme Court.

§ 1048-§ 1059. DOCTRINES OF THE STATE COURTS.

§ 1048-§ 1054. *Fully Executed Ultra Vires Contracts.*

§ 1048. **In general.** — As already stated, the decisions in the state courts upon the subject of *ultra vires* contracts display the greatest contrariety. In regard to fully executed *ultra vires* contracts, however, there is little or no disposition in the state courts to reject the principle adopted by the federal courts, although in the application thereof differences of opinion not infrequently arise. The principle itself is well nigh universally accepted that the courts will not lend their aid in order to rip open or rescind a fully executed *ultra vires* contract.⁵ The

¹ *McCutcheon v. Merz Capsule Co.*, 71 Fed. 787; 19 C. C. A. 108.

² *Gunnison Gas & Water Co. v. Whitaker*, 91 Fed. 191.

³ *St. Louis, etc. R. R. Co. v. Terre Haute, etc. R. R. Co.*, 145 U. S. 393; 12 Sup. Ct. 953.

⁴ *Supra*, § 1039.

⁵ *Long v. Georgia Pac. Ry. Co.*, 91 Ala. 519; 8 So. 706; 24 Am. St. Rep. 931 (bill to rescind sale of land which had been executed by execution of conveyance to corporation and payment by it of the purchase

money); *Hough v. Cook County Land Co.*, 73 Ill. 23 (bill against corporation to rescind contract under which land had been conveyed to the company in exchange for shares of its stock); *Railway Co. v. Iron Co.*, 46 Oh. St. 44; 18 N. E. 486; 1 L. R. A. 412 (holding that action will not lie to recover back money paid on *ultra vires* subscription to shares); *Barrow v. Nashville, etc. Turnpike Co.*, 9 Humph. (Tenn.) 304 (bill to rescind conveyance of land for other than corporate pur-

effect of this principle is that the acts of a corporation cannot be attacked collaterally on the ground of *ultra vires*. Thus, in an action on a contract made by a firm composed of a corporation and an individual, the defendant cannot object that the corporation had no power to enter into a partnership.¹ So, a corporation which acquires a promissory note from the payee or an endorsee may recover on the note against the maker or a prior endorser, notwithstanding the fact that the acquisition of the note may have been *ultra vires*:² if an action were brought

poses); *Edwards v. Fairbanks*, 27 La. Ann. 449 (property sold to corporation under *ultra vires* contract not seizable on execution against vendor); *City of Spokane v. Amsterdamsch Trustees Kantoer* (Wash.), 60 Pac. 141; 22 Wash. 172 (*ultra vires* sale of all property of company); *Parish v. Wheeler*, 22 N. Y. 494 (holding that mortgage by corporation of property which it had acquired but had no power to acquire or hold passes good title to mortgagee); *Hagerstown Mfg. Co. v. Keedy*, 91 Md. 430; 46 Atl. 965 (bill to rescind sale of land after acceptance of deed and payment of price); *Louisville Tobacco Warehouse Co. v. Stewart* (Ky.), 70 S. W. 285 (recovery not allowed on note given for money paid defendant corporation to be used in buying tobacco for plaintiff where, although defendant had no power to buy the tobacco, it had been bought and delivered to plaintiff, thus fully executing the contract); *Graton & Knight Mfg. Co. v. Redelsheimer*, 28 Wash. 370 (money paid upon *ultra vires* purchase completed by delivery of the goods not to be recovered back).

Cf. *Marble Co. v. Harvey*, 92 Tenn. 115; 20 S. W. 427; 18 L. R. A. 252; 36 Am. St. Rep. 71; *Southern Bldg., etc. Ass'n v. Casa Grande Stable Co.*, 29 So. 654; 128 Ala. 624 (as to the necessity of offering to do equity by restoring the consideration received for the contract).

¹ *Wilson v. Carter Oil Co.*, 33 S. E. 249; 46 W. Va. 469; *French v. Donahue*, 29 Minn. 111; 12 N. W. 354; *Willey v. Crocker-Woolworth Nat. Bank* (Cal.), 72 Pac. 832; *Huguenot Mills v. Jempson & Co.*, 68 S. Car. 363; 47 S. E. 687 (where the corporation having taken an assignment from its co-partner sued alone and recovered for goods sold by the partnership).

² *Nat. Pemberton Bank v. Porter*, 125 Mass. 333; 28 Am. Rep. 235; *Franklin Ave., etc. Savings Inst. v. Board of Education*, 75 Mo. 408; *John V. Farwell Co. v. Wolf*, 96 Wisc. 10; 70 N. W. 289; 71 N. W. 109; 65 Am. St. Rep. 22; 37 L. R. A. 138 (purchase of claim for a tort); *Merchants' Nat. Bank v. Hanson*, 33 Minn. 40; 53 Am. Rep. 5 (overruling *First Nat. Bank v. Pierson*, ubi infra, as to questions of federal law); *United German Bank v. Katz*, 57 Md. 128 (attempting to distinguish *Lazear v. Nat. Union Bank*, 52 Md. 78; 36 Am. Rep. 355); *Black v. First Nat. Bank*, 96 Md. 399, 54 Atl. 88; *State Ins. Co. v. Farmers' Mut. Ins. Co.*, 90 N. W. 997; 65 Nebr. 34 (*ultra vires* purchase by one insurance company of claims against another for unearned premiums); *Guffey Petroleum Co. v. Chaison Townsite Co.* (Tex.), 107 S. W. 609.

Cf. *Mut. Life Ins. Co. v. Wilcox*, 8 Biss. 203; *Hopkins County v. St. Bernard Coal Co.*, 70 S. W. 289; 24 Ky. Law Rep. 942; *Russell v. Cassidy*, 108 Mo. App. 577; 84 S. W.

on the note against the person from whom the company itself acquired it, a very different point would be raised, as the question of *ultra vires* would then come up directly instead of collaterally.¹ Upon the same principle, in an action by a corporation as landlord against a lessee, it is no defence that the corporation abused its powers by erecting a building which is larger than is needed for its corporate purposes and which comprises the demised premises.² As in the federal courts,³ the passing of mere equitable title to the corporation under an *ultra vires* contract will not be deemed execution of the contract.⁴

§ 1049. **Ultra Vires Acquisition of Shares in other Corporations.**

— Where a corporation having no corporate power to acquire shares in other companies does nevertheless take a transfer of shares in another corporation, it cannot compel the last mentioned corporation to register the transfer;⁵ for although, as regards third persons in general, the change of ownership of the shares may perhaps be complete upon execution of the transfer, so that they could not question the transferee's title to the shares collaterally, yet as regards the other corporation, the transfer is not complete until registered and the registration

171 (note payable to corporation enforceable against maker although the company had no power to acquire it).

Contra: *Straus v. Eagle Insurance Co.*, 5 Oh. St. 59; *Farmers', etc. Bank v. Baldwin*, 23 Minn. 198; 23 Am. Rep. 683; *First Nat. Bank v. Pierson*, 24 Minn. 140; 31 Am. Rep. 341; *Talmage v. Pell*, 7 N. Y. 328 (holding that assignment by corporation of a mortgage in exchange for property which the corporation had no power to acquire passes no title to the assignee).

As to acquisition of title to a note by an usurious discounting, see cases cited *infra*, § 1071.

¹ Cf. *New York State, etc. Trust Co. v. Helmer*, 77 N. Y. 64.

See, however, *Prescott Nat. Bank v. Butler*, 157 Mass. 548; 32 N. E. 909 (holding that power of corporation to purchase note cannot be

attacked in suit by corporation as endorsee against endorser, and being, therefore, it would seem, sustainable only on the doctrine, which is generally supposed to be repudiated in Massachusetts, that an action will lie on an *ultra vires* contract which has been fully executed on the part of the plaintiff).

² *Rector v. Hartford Deposit Co.*, 190 Ill. 380; 60 N. E. 528.

³ *Supra*, § 1037.

⁴ Cf. *Coleman v. San Rafael, etc. Co.*, 49 Cal. 517 (where a landowner maintained a suit to remove as a cloud on title a bond to convey to a person in trust for the shareholders in a corporation and their successors in interest land which the corporation had no power to hold).

⁵ *Franklin Bank v. Commercial Bank*, 36 Oh. St. 350; 38 Am. Rep. 594. See also *supra*, § 878.

of the transfer would involve entering into the contract of membership with the transferee corporation — a contract which that company had no power to make. If the transfer is registered, the transferee corporation possesses some at least of the rights of a shareholder.¹ On the other hand, we have seen that according to the doctrine of the federal courts, even in that case the transferee corporation incurs none of the liabilities of a shareholder.² Other courts take a different position upon this latter point.³ All American authorities would agree that a person to whom the corporation retransfers the shares gets an indefeasible title as against all the world.⁴

§ 1050. **Devise, Legacy, or Conveyance in Excess of Amount of Property which Corporation is Authorized to Hold, or for Ultra Vires Purpose.** — There has been much difference of opinion as to the effect to be given to a limitation upon the amount of property which a corporation may hold. In an early Pennsylvania case, the court applied the analogy of English mortmain acts and held that the corporation could take property in excess of the limit and could therefore transmit title thereto, but that neither the corporation nor its grantee could hold as against the state, which had the right to intervene and confiscate the property.⁵ In Virginia, on the other hand, the court refused

¹ *Milbank v. New York, etc. R. R. Co.*, 64 How. Pr. (N. Y.) 20 (declaring that the corporation has the right to collect dividends but not to vote). As to the right to vote, see *infra*, § 1231.

² *Supra*, § 1034.

³ *Kennedy v. California Sav. Bank*, 101 Cal. 495; 35 Pac. 1039; 40 Am. St. Rep. 69 (although this decision related to liability in a national bank and was reversed on writ of error, *sub. nom. California Bank v. Kennedy*, 167 U. S. 362; 17 Sup. Ct. 831, yet the decision of the state court still stands as regards California corporations); *City of Goodland v. Bank of Darlington*, 74 Mo. App. 365 (proceeding on the ground that an action will lie on an *ultra vires* contract which has been fully executed on one side); *Wright v. Pipe Line Co.*, 101 Pa. St. 204;

47 Am. Rep. 701; *Hunt v. Hauser Malting Co.*, 96 N. W. 85; 90 Minn. 282; *Hunt v. Hauser Malting Co.*, 103 N. W. 1032; 95 Minn. 206; *Fidelity Ins. Co. v. German Sav. Bank*, 127 Iowa 591; 103 N. W. 958.

⁴ *Milbank v. New York, etc. R. R. Co.*, 64 How. Pr. (N. Y.) 20 (semble); *Bigbee, etc. Packet Co. v. Moore*, 121 Ala. 379; 25 So. 602 (transferee entitled to collect dividends on the shares); *Holmes & Griggs Mfg. Co. v. Holmes & Wessell Metal Co.*, 127 N. Y. 252; 27 N. E. 831; 24 Am. St. Rep. 448 (semble, a corporation which has no power to purchase shares in other companies may, after such a purchase has been made, sell the shares and recover the stipulated price from the purchaser).

⁵ *Leazure v. Hillegas*, 7 Serg. & R. (Pa.) 313 (with which compare *Commonwealth v. New York, etc. R.*

to apply the analogy of the mortmain acts and held that the corporation acquires a good title and can maintain a bill for specific performance against a purchaser, the restrictive statute being declared to be directory merely.¹ So, also, in other states, the courts construe the statute as making the acquisition of property in excess of the limit merely *ultra vires*, and hold that a good title will pass to the company.² This result should undoubtedly be reached where a corporation which has power to purchase land for one purpose purchases land for a different purpose.³ On the other hand, there are high authorities that

Co., 132 Pa. St. 591; 19 Atl. 291; 7 L. R. A. 634); *Bone v. Delaware, etc. Canal Co.* (Pa.), 5 Atl. 751. Cf. *American Mtge. Co. v. Tennille*, 87 Ga. 28; 13 S. E. 158; 12 L. R. A. 529 (as to foreign corporations). No case is known in which the supposed right of the state to confiscate the property has been held to be properly exercised. Cf. *Louisville School Board v. King* (Ky.), 107 S. W. 247 (holding that the right of confiscation is lost if the property is assigned by the corporation before institution of confiscation proceedings).

¹ *Fayette Land Co. v. Louisville, etc. R. R. Co.*, 93 Va. 274; 24 S. E. 1016.

² Cf. *Henderson v. Virden Coal Co.*, 78 Ill. App. 437 (grantor not entitled to have deed cancelled as a cloud on his title); *Miller v. Flemingsburg, etc. Turnpike Co.* (Ky.), 59 S. W. 512; 22 Ky. Law Rep. 1039 (title of corporation good against grantor); *De Camp v. Dobbins*, 29 N. J. Eq. 36 (holding that devise in excess of limit passes good title as against heirs to real estate and proceeds of land sold by executors under power), affirmed on another ground but questioned as to this point in s. c. 31 N. J. Eq. 671, 690; *Farrington v. Putnam*, 90 Me. 405; 37 Atl. 652; 38 L. R. A. 339 (holding that unless state objects title vests in legatee in excess of the limit rather than in next of

kin); *Hanson v. Little Sisters of the Poor*, 79 Md. 434; 32 Atl. 1052; 32 L. R. A. 293 (where the court declared that the doctrine of *ultra vires* as applied to contracts generally had no application to a legacy or devise in excess of the limit and that "the corporation can take property to any amount but can hold it, as against the state, only to the amount provided by its charter," but intimated that a grantee from the corporation would take an indefeasible title); *Re Stickney's Will*, 85 Md. 79; 60 Am. St. Rep. 308; 36 Atl. 654; 35 L. R. A. 693 (devise in excess of charter limit good against heir).

³ *Hough v. Cook County Land Co.*, 73 Ill. 23; *Walsh v. Barton*, 24 Oh. St. 28; *Hamsher v. Hamsher*, 132 Ill. 273, 286; 23 N. E. 1123 (title to land not needed for corporate purposes when devised to corporation vests in it and not in heir); *Rutland, etc. R. R. Co. v. Proctor*, 29 Vt. 93 (action maintainable by corporation on contract to sell the property originally acquired for *ultra vires* purpose); *Banks v. Poitiaux*, 3 Rand. (Va.) 136; 15 Am. Dec. 706 (suit by corporation for specific performance of contract for sale of the property maintainable); *Nantasket Beach, etc. Co. v. Shea*, 182 Mass. 147; 65 N. E. 57 (holding that the company may recover rental reserved on a lease of the property executed by it); *Natoma Water, etc.*

where the capacity of a corporation to hold property is limited as to amount, the corporation can acquire no title to property in excess of the limit either by deed¹ or will.² Even these courts would probably hold that a corporation may by adversary possession acquire the right to hold property in excess of the limit without let or hindrance from any person except the state.³

Co. v. Clarkin, 14 Cal. 544 (ejectment maintainable by corporation); *Springer v. Chicago Real Estate, etc. Co.*, 202 Ill. 17; 66 N. E. 850 (corporation entitled to recover rent from a lessee). Cf. *infra*, § 1061.

Cf. *Long v. Georgia Pac. Ry. Co.*, 91 Ala. 519; 8 So. 706; 24 Am. St. Rep. 931; *Lancaster v. Amsterdam Imp. Co.*, 140 N. Y. 576; 35 N. E. 964; 24 L. R. A. 322; *Alexander v. Tolliston Club*, 110 Ill. 65 (injunction granted against wrongful interference with property right); *Barnes v. Suddard*, 117 Ill. 237; 7 N. E. 477 (holding that no title remains in grantor or his privies); *Cooney v. Booth Packing Co.*, 169 Ill. 370; 48 N. E. 406 (corporation entitled to maintain statutory proceeding for confirmation of title which was based on burnt records); *Chicago, etc. R. R. Co. v. Keegan*, 185 Ill. 70; 56 N. E. 1088 (ejectment by corporation maintainable); *South & North Ala. R. R. Co. v. Highland Ave., etc. R. R. Co.*, 119 Ala. 105; 24 So. 114 (contract not enforced while remaining executory); *Chicago, etc. R. R. Co. v. Lewis*, 53 Iowa 101, 113; 4 N. W. 842 (ejectment by corporation); *Mallett v. Simpson*, 94 N. Car. 37; 55 Am. Rep. 594 (action in nature of ejectment by person claiming under grant from corporation); *Gilbert v. Hole*, 2 S. Dak. 164; 49 N. W. 1 (bill by person claiming under grantor to quiet title to the land conveyed to corporation for speculation); *Barrow v. Nashville, etc. Turnpike Co.*, 9 Humph. (Tenn.) 304 (bill by grantor for rescission not maintainable); *Summet v. City Realty, etc. Co. (Mo.)*, 106 S. W. 614.

¹ *St. Peters R. C. Congregation v. Germain*, 104 Ill. 440 (ejectment not maintainable by corporation).

² *Re McGraw*, 111 N. Y. 66; 19 N. E. 233; 2 L. R. A. 387 (an elaborate opinion of Judge Peckham who, giving an exhaustive review of the authorities and distinguishing the case of a deed or other conveyance *inter vivos* which passes title as against the grantor or his representatives, holds that devise or bequest in excess of the statutory limit is void and that the title vests in the heirs or next of kin), affirmed as to federal questions in *Cornell University v. Fiske*, 136 U. S. 152; 10 Sup. Ct. 775; *House of Mercy v. Davidson*, 90 Tex. 529; 39 S. W. 924 (distinguishing the case of a deed from a devise in excess of the limit and holding that such a devise will not pass title, which vests in the heirs); *Wood v. Hammond*, 16 R. I. 98; 17 Atl. 324; 18 Atl. 198; *Cromie's Heirs v. Louisville Orphans' Home*, 3 Bush. (Ky.) 365 (excess of real estate devised to corporation goes to heir, excess of personal property to next of kin); *Davidson College v. Chambers' Exors.*, 3 Jones Eq. (N. Car.) 253 (legatee entitled to collect by suit only so much of legacy as added to other property of corporation would equal statutory limit, balance vesting in next of kin).

As to the effect of an exception of devises to corporations from the operation of the Statute of Wills, see *supra*, § 75.

³ *Harpending v. Dutch Church*, 16 Pet. 455 (headnote inadequate); *Humbert v. Trinity Church*, 24 Wend.

§ 1051. **Ultra Vires Guarantee.** — In case of an *ultra vires* guarantee by a corporation, it has been held that the company on paying the debt cannot recover the amount paid from the principal.¹ This is rather a harsh decision, as the only *ultra vires* contract — that is, the guaranty — had been fully executed; and therefore it is not surprising to find a decision in which in a similar case recovery was allowed.²

§ 1052. **Ultra Vires Contract of Insurance — What is full Performance.** — A comparatively early Maryland case which apparently rips open an executed *ultra vires* contract may be supported on other grounds. A hospital corporation agreed with F. in consideration of a cash payment of twelve hundred dollars to support F.'s sister so long as she might live. F. paid the money, and the corporation supported his sister until her death, which occurred about a year afterwards. The court held that the contract, being in the nature of life insurance, was *ultra vires* of the hospital corporation, and void, and that therefore F. might recover back the amount of the premium less whatever necessary expenses the hospital had incurred in supporting the woman during her life.³ At first blush, the contract seems to have been fully executed by both parties. F. had paid the premium — all that under the terms of the contract he had agreed to do; and the corporation had supported the woman until her death — all that it had agreed to do. Moreover, the *ratio decidendi* was broad enough to justify the ripping open of any merely *ultra vires* executed contract. So regarded, the decision is out of harmony with other cases in the same court. Nevertheless, the case can be supported on another ground. As already mentioned, the contract was in effect a contract of insurance; and in any contract of insurance what the insured wants is the "protection" — the binding obligation of the insurer to perform. Unless he has had this protection the

(N. Y.) 587; *Bogardus v. Trinity Church*, 4 Paige (N. Y.) 178, all of which cases are explained in *Re McGraw*, 111 N. Y. 66, 100-101; 19 N. E. 233; 2 L. R. A. 387. *v. Watertown, etc. Plank Road Co.*, 7 Wisc. 59 (distinguished in *Northwestern Union Packet Co. v. Shaw*, 37 Wisc. 655, 662; 19 Am. Rep. 781).

Cf. *Gump v. Sibley*, 79 Md. 165; *Regents of University of Md. v. Calvary M. E. Church*, 104 Md. 635. ² *Macon, etc. R. R. Co. v. Georgia R. R. Co.*, 63 Ga. 103, 119-120. ³ *Maryland Hospital v. Foreman*,

¹ *Madison, etc. Plank Road Co.* 29 Md. 524.

contract cannot be said to have been fully executed. Moreover, the cases cited by the court in support of its conclusion were cases of partially executed *ultra vires* contracts, where the party who had performed recovered from the other party *quasi ex contractu* to the extent of benefits received by the latter.

In further illustration of the true ground for the decision in *Maryland Hospital v. Foreman*, take as example an *ultra vires* contract of fire insurance. The insured pays the premium and the house covered by the policy does not burn down, so that the insurer is never called upon to pay a loss. Nevertheless, the contract has not been fully performed; for the insured has not had the benefit which a binding contract of insurance would have secured. He has not been protected against loss unless he could have enforced the insurer's promise if a loss had occurred. Consequently, any court which would hold that in case of loss the contract could not be enforced against the company should also hold that even if no loss occurs the insured should be able to recover back the premium on the ground of failure of consideration. If loss occurs and is paid, then indeed the contract may be deemed fully performed, but not otherwise.

§ 1053. **Ultra Vires Purchase as Bona Fide Purchase sufficient to cut off Equities.** — Some of the state courts carrying out logically the doctrine that a fully executed *ultra vires* contract is effective have held that a corporation may be a *bona fide* purchaser of property which it had no corporate capacity to acquire, and may accordingly take the same free from any mere equities of which at the time of the purchase it had no notice.¹ The Court of Appeals of Maryland in an early case took the opposite view.²

§ 1054. **Rescission of Executed Ultra Vires Contract on ground of Fraud.** — If an *ultra vires* contract be procured by fraud or misrepresentation, then upon any view of the law of *ultra vires* the defrauded party may avoid the contract, and may have any remedies for the restoration of the *status in quo* that would have been available if the contract had been *intra vires*.³

¹ *Schneider v. Sellers*, 84 S. W. Am. St. Rep. 725; *Bale v. Michigan* 417; 98 Tex. 380. *Tontine Investment Co.*, 93 N. W.

² *Albert v. Savings Bank*, 2 Md. 159. 1071; 132 Mich. 479; *Edwards v.*

³ *Carr v. Nat. Bank & Loan Co.*, *Michigan Tontine Investment Co.*, 167 N. Y. 375; 60 N. E. 649; 82 92 N. W. 491; 132 Mich. 1.

§ 1055-§ 1056. *Partly Executed Ultra Vires Contracts.*

§ 1055. **In general — Whether Action will lie on the Contract.** — Some of the state courts agree with the federal courts in holding that no action will lie on an *ultra vires* contract even though fully executed on the part of the plaintiff.¹ But a larger number

¹ *Davis v. Old Colony R. R. Co.*, 131 Mass. 258; 41 Am. Rep. 221 (with which compare, however, *Slater Woollen Co. v. Lamb*, 143 Mass. 420; 9 N. E. 823, where the court regarded the question as still open in Massachusetts, and *Prescott Nat. Bank v. Butler*, 157 Mass. 548; 32 N. E. 909, which is commented on *supra*, p. 845, n. 1); *Western Md. R. R. Co. v. Blue Ridge Hotel Co.*, 102 Md. 307; 62 Atl. 351; 111 Am. St. Rep. 362 (*ultra vires* guaranty); *Rockhold v. Canton Masonic Benev. Soc.*, 129 Ill. 440, 457; 21 N. E. 794; 2 L. R. A. 420; *Memphis, etc. R. R. Co. v. Grayson*, 88 Ala. 572; 7 So. 122; 16 Am. St. Rep. 69 (*ultra vires* railway lease); *New York Firemen Ins. Co. v. Eley*, 5 Conn. 560; 13 Am. Dec. 100 (*ultra vires* discounting of note); *Simpson v. Building, etc. Ass'n*, 38 Oh. St. 349, 357; *Downing v. Mt. Washington Road Co.*, 40 N. H. 230; *National Home Bldg. Ass'n v. Home Sav. Bank*, 181 Ill. 35; 54 N. E. 619; 72 Am. St. Rep. 245; 64 L. R. A. 399 (settling the law of Illinois and rendering the earlier cases, in that state, some of which are cited *infra*, p. 852, n. 1, dangerous to rely upon as authorities); *Brunswick Gas Light Co. v. United Gas, etc. Co.*, 85 Me. 532 (lessor in *ultra vires* lease of gas works no remedy against lessee who had thrown up lease during term); *Lucas v. White Line Transfer Co.*, 70 Iowa 541; 30 N. W. 771; 59 Am. Rep. 449 (corporation making *ultra vires* guarantee not liable for contribution to co-surety who has paid debt); *Assignment Mut., etc. Ins. Co.*, 107 Iowa 143; 77 N. W. 868; 70 Am. St. Rep. 149; *Willett v. Farmers'*

Sav. Bank, 107 Iowa 69; 77 N. W. 519; *Best Brewing Co. v. Klassen*, 185 Ill. 37; 57 N. E. 20; 76 Am. St. Rep. 26 (contract of suretyship); *Marble Co. v. Harvey*, 92 Tenn. 115; 20 S. W. 427; 18 L. R. A. 252; 36 Am. St. Rep. 71 (corporation making *ultra vires* purchase of stock not allowed to recover from vendor for debts of company which he had assumed as part of the transaction and had refused to pay, and which the company was obliged to pay); *Chewacha Line Works v. Dismukes*, 87 Ala. 344; 6 So. 122; 5 L. R. A. 100; *Miller v. Insurance Co.*, 92 Tenn. 167; 21 S. W. 39; 20 L. R. A. 765 (semble, no liability for loss on *ultra vires* contract of insurance); *Norton v. Derby Nat. Bank*, 61 N. H. 589, 592; 60 Am. Rep. 334 (*ultra vires* guarantee by national bank); *Talmage v. Pell*, 7 N. Y. 328 (inconsistent with later New York cases cited *infra*, p. 852, n. 1); *Scott v. Bankers' Union* (Kans.), 85 Pac. 604 (promissory notes issued by a corporation which had no power to emit commercial paper); *Metropolitan Stock Exch. v. Lyndonville Nat. Bank*, 57 Atl. 101; 76 Vt. 303; *Greene v. Middlesborough Town, etc. Co.*, 89 S. W. 228; 28 Ky. Law Rep. 303 (*ultra vires* guaranty of securities of another corporation); *Tennessee Ice Co. v. Raine*, 107 Tenn. 151, 154; 64 S. W. 29 (semble).

Cf. *Deaton Grocery Co. v. International Harvester Co.* (Tex.), 105 S. W. 556 (where the court said that performance by the plaintiff would not enable him to enforce the contract because the defendant had received nothing "tangible").

of state courts hold that where an *ultra vires* contract has been fully executed by one party, the party so performing should be allowed to recover on the contract for the failure of the other party to perform on his side.¹ This rule is often said to be based

¹ *Bath Gas Light Co. v. Claffy*, 134 (ultra vires contract of insurance); *Boyd v. Am. Carbon Black Co.*, 182 Pa. St. 206; 37 Atl. 937 (ultra vires contract of partnership sufficient to sustain bill for a partnership accounting); *Woodruff v. Erie Ry. Co.*, 93 N. Y. 609 (suit to compel lessee of railway to perform specifically covenants for payment of coupons, etc. in lieu of rental); *Prairie Lodge v. Smith*, 58 Miss. 301 (with which, however, *Greenville Compress, etc. Co. v. Planters' Compress, etc. Co.*, 70 Miss. 669; 13 So. 879; 35 Am. St. Rep. 681, should be compared); *Wright v. Hughes*, 119 Ind. 324; 21 N. E. 907; 12 Am. St. Rep. 412 (ultra vires mortgage); *Wittmer Lumber Co. v. Rice*, 23 Ind. App. 586 (ultra vires contract of suretyship); *Oil Creek, etc. R. R. Co. v. Pa. Transportation Co.*, 83 Pa. St. 160; *City of Goodland v. Bank of Darlington*, 74 Mo. App. 365 (liability as shareholder upon shares purchased ultra vires); *Chapman v. Iron Clad Rheostat Co.*, 62 N. J. Law 497; 41 Atl. 690 (contract of corporation to purchase its own shares); *Linkauf v. Lombard*, 137 N. Y. 417; 33 N. E. 472; 33 Am. St. Rep. 743; 20 L. R. A. 48 (contract of carriage by corporation conducting ultra vires business of a carrier); *Milborne v. Royal Benefit Soc.*, 14 N. Y. App. Div. 406; 43 N. Y. Supp. 1026 (assuming outstanding risks of another benefit society); *McElroy v. Minnesota Percheron Horse Co.*, 96 Wisc. 317; 71 N. W. 652 (contract to pay brokerage for effecting an ultra vires exchange of property); *Eckman v. Chicago, etc. R. R. Co.*, 169 Ill. 312; 48 N. E. 496; 38 L. R. A. 750; *Ward v. Johnson*, 95 Ill. 215; *Kadish v. Garden City, etc. Bldg. Ass'n*, 151 Ill. 531; 38 N. E.

upon the principle of estoppel; but, probably, a more correct statement would be that the public policy which is deemed to

236; 42 Am. St. Rep. 256; *Whitney Arms Co. v. Barlow*, 63 N. Y. 62; 20 Am. St. Rep. 504 (holding that a claim on the *ultra vires* contract is a debt of the corporation for which under a statute directors who fail to file statutory reports are liable); *Steam Nav. Co. v. Weed*, 17 Barb. (N. Y.) 378 (*ultra vires* loan by corporation); *Camden, etc. R. R. Co. v. Mays Landing, etc. R. R. Co.*, 48 N. J. Law 530 (*ultra vires* railway lease, the doctrine being laid down in somewhat more restricted terms than is customary); *Arkansas Valley, etc. Co. v. Lincoln*, 56 Kans. 145; 42 Pac. 706 (contract guaranteeing that if plaintiff would move his business near defendant's town, a railway would be built there); *Canal, etc. R. R. Co. v. St. Charles, etc. R. R. Co.*, 44 La. Ann. 1069; 11 So. 702; *Chester Glass Co. v. Deevey*, 16 Mass. 94; 8 Am. Dec. 128 (distinguished in *Davis v. Old Colony R. R. Co.*, 131 Mass. 258, 272; 41 Am. Rep. 221, on the ground that the action in the earlier case was brought by the corporation to recover damages which would be held for the corporate purposes, whereas in the later case the action was brought against the corporation); *United German Bank v. Katz*, 57 Md. 128, 142 (semble); *Black v. First Nat. Bank*, 96 Md. 399; 54 Atl. 88 (approving last case); *Heironimus v. Sweeny*, 83 Md. 146; 34 Atl. 823; 55 Am. St. Rep. 333; 33 L. R. A. 99 (loan to corporation recoverable); *German Aged People's Home v. Hammerbacher*, 64 Md. 595, 606; 54 Am. Rep. 782; 3 Atl. 678 (semble, bill for specific performance maintainable by corporation); *Rehberg v. Tontine Surety Co.*, 131 Mich. 135; 91 N. W. 132 (contract to assume debts of another corporation which had transferred its assets to defendant, including among said debts a debt owing to plaintiff); *Usher v. New York Central, etc. R. R. Co.*, 76 N. Y. App. Div. 422; 78 N. Y. Supp. 508 (contract to employ plaintiff at a salary for life in consideration of a release of claim for personal injuries, where the released claim had become barred by limitations before defendant's repudiation); *Chenoweth v. Pac. Express Co.*, 93 Mo. App. 185 (reviewing earlier Missouri cases); *Booth Bros. v. Baird*, 83 N. Y. App. Div. 495; 82 N. Y. Supp. 432; *Pannebaker v. Tuscarora Valley R. Co.* (Pa.), 67 Atl. 923; *First Nat. Bank v. Alexander* (Ala.), 44 So. 866 (holding that the doctrine does not apply unless the performance has resulted in a benefit to the other party); *Kelly v. Ning Yung Benev. Ass'n* (Cal.), 84 Pac. 321 (contract of employment of attorney-at-law); *Breinig v. Sparrow* (Ind.), 80 N. E. 37 (corporation making *ultra vires* partnership agreement liable as partner to third person); *Noah v. German-American Bldg. Ass'n*, 31 Ind. App. 504; 68 N. E. 615 (*ultra vires* loan recoverable by company); *Board of Trustees v. Piedmont Realty Co.*, 46 S. E. 723; 134 N. Car. 41 (contract with a municipal corporation to defray part of the expense of constructing a bridge near the company's property); *Peoria Star Co. v. Cutright*, 115 Ill. App. 492 (containing dicta difficult to reconcile with decisions of the Illinois Supreme Court cited supra, p. 851, n. 1); *Arkadelphia Lumber Co. v. Posey* (Ark.), 85 S. W. 1127 (*ultra vires* contract of insurance); *Whitehead v. American Lamp & Brass Co.* (N. J. Ch.), 62 Atl. 554 (*ultra vires* guaranty); *Continental Fire Ass'n v. Masonic Temple Co.* (Tex.), 62 S. W. 930 (*ultra vires* contract of insurance); *Sturdevant v. Farmers'*,

require purely executory *ultra vires* contracts to be held unenforceable is not deemed to be of such a character as to permit one party, having enjoyed the full benefit of the contract, to repudiate its burdens.¹

Many difficulties are encountered in the application of this rule. When is a contract to be deemed fully performed by one party?² What is the effect of mere part performance by one party before repudiation by the other?³ Has the party who

etc. Bank, 62 Nebr. 472; 87 N. W. 156 (limiting the doctrine to cases in which the defendant has acquired money or property by virtue of the plaintiff's performance); *Curtis v. Natalie, etc. Coal Co.*, 89 N. Y. App. Div. 61; 85 N. Y. Supp. 413, affirmed short, 181 N. Y. 543; 73 N. E. 1122 (contract to assume indebtedness of another corporation).

¹ This doctrine is often expressed by the misleading statement, "The doctrine of *ultra vires* when invoked for or against a corporation should not be allowed where it would not advance justice but on the contrary would accomplish a legal wrong." E. g., *Whitney Arms Co. v. Barlow*, 63 N. Y. 62, 69; 20 Am. St. Rep. 504 (the origin of the dictum); *Bear River, etc. Co. v. Hanley*, 15 Utah 506, 516; 50 Pac. 611. If "legal wrong" means what if the proprieties of language are followed, it can only mean, this statement is equivalent to saying that the defence of *ultra vires* should not be allowed when it should not be allowed!

² See *Mallory v. Hanaur Oil Works*, 86 Tenn. 598; 8 S. W. 396 (contract of partnership); *Bowman Dairy Co. v. Mooney*, 41 Mo. App. 665 (contract of service); *Jemison v. Citizens' Sav. Bank*, 122 N. Y. 135; 25 N. E. 264; 19 Am. St. Rep. 482; 9 L. R. A. 708 (loss on *ultra vires* contract for dealing in cotton futures not recoverable by broker); *Franklin Co. v. Lewiston Institution*, 68 Me. 43; 28 Am. Rep. 9 (stated *infra*, p. 862, n.); *Oil Creek, etc. R. R. Co. v. Pa. Transportation Co.*, 83 Pa. St.

160 (under *ultra vires* contract to pay a specified sum for every barrel of oil transported contract price may be recovered for all oil actually transported even though contract be repudiated for the future); *Gause v. Commonwealth Trust Co.*, 106 N. Y. Supp. 288 (contract by defendant to guarantee the sale by it of certain securities not deemed executed by the other party when the securities had not been delivered to the defendant).

³ That a party who has partly performed has no remedy on the contract against the other party who refuses to perform his side fully, see *Day v. Spiral Springs Buggy Co.*, 57 Mich. 146; 58 Am. Rep. 352; 23 N. W. 628; *Bowman Dairy Co. v. Mooney*, 41 Mo. App. 665; *Greenville Compress, etc. Co. v. Planters' Compress, etc. Co.*, 70 Miss. 669; 13 So. 879; 35 Am. St. Rep. 681 (where in a case relating to a partly performed agreement for consolidation of two corporations the court seems⁴ to have intended to adopt the rule of the federal courts); *Downing v. Mt. Washington Road Co.*, 40 N. H. 230; *McNulta v. Corn Belt Bank*, 164 Ill. 427, 451-452; 45 N. E. 954; 56 Am. St. Rep. 203.

Cf. *Mallory v. Hanaur Oil Works*, 86 Tenn. 598; 8 S. W. 396 (holding that the corporation having repudiated the contract in the course of performance may retake in specie property possession of which had been parted with under the contract); *Thompson v. Lambert*, 44 Iowa 239 (where the court said

has partly performed no remedy at all, or may he recover either upon the express contract,¹ or upon a *quantum meruit* to the extent of his performance?²

All these questions, and more of the same general nature, embarrass those courts which adhere to the prevalent American doctrine. The confusion in the decisions is very great, and the most profitable classification and digestion of the cases upon this subject would be confined to the decisions in some one state. The difficulty lies in the fact that few courts have consistently adhered to any one doctrine upon the subject. When in a particular case a court seems to swerve from rules laid down in previous cases, one is often at a loss to determine whether the later decision is to be regarded (1) as a mere inadvertence, (2) as an intentional departure from the earlier cases, or (3) whether some distinction is to be sought for.

§ 1056. **Liability Quasi Ex Contractu for Benefits received from Performance by opposite Party.** — In cases where an *ultra vires* contract is not enforceable but where benefits have been conferred in pursuance of the transaction upon one party or the other, the party receiving the benefits is liable to pay for them under a contract implied in law upon a *quantum meruit*. This rule may become operative in cases where the *ultra vires* contract has been partly performed by one party or, in jurisdictions where no action will lie on the contract even by a party who has fully performed, in cases where the contract has been fully performed on one side.³ This rule will be applied, how-

obiter that the doctrine of *ultra vires* applies to contracts only while they remain "wholly executory"; *Denver Fire Ins. Co. v. McClelland*, 9 Colo. 11; 9 Pac. 771; 59 Am. Rep. 134 (holding that in case of *ultra vires* contract of insurance insured who has paid a cash premium and given a premium note may recover for a loss which occurs before the note matures or is paid).

¹ *Bath Gas Light Co. v. Claffy*, 151 N. Y. 24; 45 N. E. 390; 36 L. R. A. 664 (recovery allowed on *ultra vires* lease for rent accruing while lessee was in possession).

² That the party who has partly performed has a remedy *quasi ex*

contractu, see *Day v. Spiral Springs Buggy Co.*, 57 Mich. 146; 58 Am. Rep. 352; 23 N. W. 628, and *infra*, § 1056.

³ *Norton v. Derby Nat. Bank*, 61 N. H. 589, 593-594 (headnote inadequate); 60 Am. Rep. 334; *Miller v. Insurance Co.*, 92 Tenn. 167, 177; 21 S. W. 39; 20 L. R. A. 765 (semble); *Morville v. Am. Tract Soc.*, 123 Mass. 129; 25 Am. Rep. 40; *Allen v. Freedman's Sav. & Trust Co.*, 14 Fla. 418; *Brown v. City of Atchison*, 39 Kans. 37, 54; 17 Pac. 465; 7 Am. St. Rep. 515; *Northwestern Union Packet Co. v. Shaw*, 37 Wisc. 655; 19 Am. Rep. 781; *Pauly v. Pauly*, 107 Cal. 8; 40

ever, only where a substantial benefit has been received. For example, where a corporation which has no power to purchase shares in other corporations makes a contract by which a third person pays for the shares and takes a transfer of them as collateral security for the advance, no property has passed to the corporation under the contract and it incurs no quasi-contractual liability to repay the amount of the money paid.¹

Moreover, the rule has not always been logically carried out. For instance, where a manufacturing company made an *ultra vires* subscription to shares in a railway company to be paid for with goods to be manufactured for the railway company,

Pac. 29; 48 Am. St. Rep. 98; *Tracy v. Talmage*, 14 N. Y. 162; 67 Am. Dec. 132; *Curtiss v. Leavitt*, 15 N. Y. 1 (reaffirming points decided in last case); *Day v. Spiral Springs Buggy Co.*, 57 Mich. 146; 23 N. W. 628; 58 Am. Rep. 352 (where plaintiff has partly performed); *Maryland Hospital v. Foreman*, 29 Md. 524 (explained supra, § 1052); *Edwards v. Michigan Tontine Investment Co.*, 92 N. W. 491; 132 Mich. 1 (money paid under partly executed *ultra vires* contract recovered back in equity); *Tennessee Ice Co. v. Raine*, 107 Tenn. 151; 64 S. W. 29.

See supra, § 1045, for decisions of the federal courts. As to recovery for loans made to corporations in excess of a charter limit of indebtedness, see supra, § 118, and infra, § 1705.

Cf. *Manchester, etc. R. R. v. Concord R. R.*, 66 N. H. 100; 20 Atl. 383; 9 L. R. A. 689; 49 Am. St. Rep. 582 (a case which is somewhat obscure on account of the reporter's failure fully to state the facts); *Slater Woollen Co. v. Lamb*, 143 Mass. 420; 9 N. E. 823 (where the court left the question open whether in case of an *ultra vires* sale recovery may be had on the contract for the contract price or *quasi ex contractu* for the reasonable value of the goods); *White v. Franklin Bank*, 22 Pick. 181 (previous demand not a prerequisite to maintenance of

action); *Interstate Hotel Co. v. Woodward, etc. Amusement Co.*, 103 Mo. App. 198; 77 S. W. 114 (where the express contract was unenforceable under the Statute of Frauds as well as *ultra vires*). In *Chewacla Lime Works v. Dismukes*, 87 Ala. 344; 6 So. 122; 5 L. R. A. 100, this quasi-contractual liability was apparently denied. In *Chapman v. Lynch*, 156 N. Y. 551; 51 N. E. 275, where a corporation acting *ultra vires* accepted a deposit of money repayable on demand, the court held that as the depositor might forthwith have maintained an action for recovery of the money in disaffirmance of the contract, the statute of limitations began to run immediately, even before a demand. This is a curious decision inasmuch as the New York courts hold that an *ultra vires* contract fully executed on one side will support an action, and inasmuch as the depositor had not in fact repudiated the contract. In *Appleton v. Citizens' Nat. Bank*, 83 N. E. 470; 190 N. Y. 418, it was held that a person who lends money in order to enable the borrower to pay a debt owing to a bank, which makes an *ultra vires* guarantee of payment, may recover from the bank to the extent the borrowed money was used in paying its claim.

¹ *Franklin Co. v. Lewiston Institution*, 68 Me. 43; 28 Am. Rep. 9.

it was held that the manufacturing company, having delivered a part of the stipulated quantity of goods and having refused to deliver the balance on the ground that the subscription was *ultra vires*, could not recover from the railway company in disaffirmance of the contract the value of the goods delivered.¹ In an early Alabama case, although the general principle was recognized, the court refused to apply it to an *ultra vires* loan because the effect would be to permit the company to recover the same amount as would have been recoverable if the contract had been binding.² The fact that the amount recoverable in disaffirmance of the contract is the same as would have been recoverable if the contract had been binding is certainly no reason for refusing to allow a disaffirmance and restoration of the *status in quo*. It is not likely that the case would be followed in Alabama; and certainly it would not be followed in other states.

Of course, the claim upon a *quantum meruit* for benefits conferred by the plaintiff upon the defendant under an *ultra vires* contract between them is a mere unsecured simple-contract claim, and is not entitled to any preference over other debts or obligations of the defendant. For instance, where money is lent by a corporation to a third person who becomes insolvent, the company cannot on repudiating the loan as *ultra vires* recover the money as a preferred claim against the borrower's estate.³

§ 1057-§1058. *Wholly Executory Contracts.*

§ 1057. **In Cases where Shareholders unanimously Assent.**

—Some American courts would probably hold that an *ultra vires* contract, the making of which is authorized or ratified by all the shareholders, is valid as a corporate act, if no rights of creditors are involved.⁴ This conclusion can be reached only by disregarding the corporate entity, and treating the corporation as a mere aggregation of natural persons. Indeed, in Eng-

¹ *Railway Co. v. Iron Co.*, 46 Oh. St. 44; 18 N. E. 486; 1 L. R. A. 412.

² *Grand Lodge v. Waddill*, 36 Ala. 313.

³ *Garrison Canning Co. v. Stanley* (Iowa), 110 N. W. 171 (proceeding on the ground that the con-

tract having been fully executed on one side could not be repudiated by either party).

⁴ Cf. *Martin v. Niagara Falls Paper Mfg. Co.*, 122 N. Y. 165, 172-173; 25 N. E. 303; *Perkins v. Trinity Realty Co.* (N. J. Ch.), 61 Atl. 167.

land, one of the main distinctions between a mere voluntary association and a corporation or statutory registered company lies in the fact that in the case of the former the unanimous consent of the members may, whereas in the case of the latter it may not, justify the diversion of the funds of the company to other than its original purposes.¹

§ 1058. **In other Cases.** — Except, perhaps, in such cases, the authorities, until recently, have been agreed that a purely executory *ultra vires* contract will not sustain an action or suit. Of course, any court which adopts the doctrine of the federal courts in regard to *ultra vires* contracts executed on one side would *a fortiori* apply the same rule to purely executory contracts.² Even those courts which allow an action to be maintained by a party who has fully performed his side of an *ultra vires* contract would not allow an action on a purely executory contract.³ Thus, a suit for specific performance will not lie by a railway corporation on a contract to sell certain coal lands and mining rights.⁴

On the other hand, the Supreme Court of Kansas, in a recent well-considered opinion, has adopted the revolutionary doctrine that an action will lie upon a wholly executory *ultra vires* contract and that the question of *ultra vires* can be raised only by the state.⁵ It is not improbable that this decision will be followed by other courts of radical tendencies and scant respect for mere authority. This doctrine was first advocated in this country by Mr. George Wharton Pepper, of Philadelphia, in an able essay in the Harvard Law Review.⁶ If the question were *res integra*, the inclination to take this extreme view of the matter would doubtless be very strong; but at this late day a

¹ 1 Lindley on Companies, 6th N. Y. 115; 47 Am. Rep. 14 (action ed., 214-215. by corporation on executory contract to purchase stocks and bonds of other corporations); *McNulta v. Corn Belt Bank*, 164 Ill. 427, 451-452; 45 N. E. 954; 56 Am. St. Rep. 203; *Nebraska Shirt Co. v. Horton*, 93 N. W. 225; 3 Nebr. (unofficial) 888.

² *Coppin v. Greenlees, etc. Co.*, 38 Oh. St. 275; 43 Am. Rep. 425 (action against company on executory contract to purchase its own stock).

³ *Screven Hose Co. v. Philpot*, 53 Ga. 625 (action by corporation); *Northwestern Union Packet Co. v. Shaw*, 37 Wisc. 655; 19 Am. Rep. 781 (action by corporation for non-delivery of personal property in pursuance of *ultra vires* contract of sale); *Nassau Bank v. Jones*, 95 N. Y. 115; 47 Am. Rep. 14 (action by corporation on executory contract to purchase stocks and bonds of other corporations); *McNulta v. Corn Belt Bank*, 164 Ill. 427, 451-452; 45 N. E. 954; 56 Am. St. Rep. 203; *Nebraska Shirt Co. v. Horton*, 93 N. W. 225; 3 Nebr. (unofficial) 888.

⁴ *Wilks v. Georgia Pac. R. Co.*, 79 Ala. 180.

⁵ *Harris v. Independence Gas Co.* (Kans.), 92 Pac. 1123.

⁶ 9 Harv. L. Rev. 255.

court which takes this position without any affirmative legislative sanction would seem to be almost if not quite guilty of usurping the functions of the legislature.

§ 1059. **Contracts Ultra Vires in Part.** — In the case of contracts which are *ultra vires* in part, — that is to say, where only part of what the corporation engages to perform is *ultra vires*, — the court will struggle to separate the part which is *ultra vires* from the part that is unobjectionable; and wherever the separation can be made, the unobjectionable part may be enforced although purely executory.¹ For example, we have seen that where a limit is imposed on the amount of indebtedness which a corporation may incur, a loan which extends beyond the limit may be enforced up to the limit even though void as to the excess.² In some cases, however, the contract must stand or fall as an entirety.³ Thus, where a corporation makes an entire contract for the purchase of several articles, some of which it has no power to hold, and where it has accepted the articles which it has power to acquire and thereby ratified the contract, the other party may nevertheless reject such ratification, claiming that the contract is entire; but on the other hand, the company cannot complain if the other party claims the benefit of the partial ratification, and sues to recover the purchase price of the articles accepted by the company.⁴

§ 1060-§ 1071. **CLASSES OF CONTRACTS TO BE DISTINGUISHED FROM ULTRA VIRES CONTRACTS.**

§ 1060. **Contracts made in irregular Manner but not in Substance Ultra Vires.** — After this general view of the several

¹ *Kansas Valley Nat. Bank v. Rep.* 1684; *First Nat. Bank v. D. Rowell*, 2 Dillon 371 (note that in some respects this case is in conflict with later decisions of the Supreme Court cited *supra*, § 1042).

Kieffer Milling Co., 95 Ky. 97; 23 S. W. 675. See *supra*, § 118.

³ Cf. *Brown v. City of Atchison*, 39 Kans. 37; 17 Pac. 465; 7 Am. St. Rep. 515; *Nassau Bank v.*

etc. Mfg. Co., 46 Atl. 1054; 70 N. H. 118; *Kraniger v. People's Building Soc.*, 60 Minn. 94; 61 N. W. 904;

Jones, 95 N. Y. 115 (headnote inadequate); 47 Am. Rep. 114.

Bell & Coggeshall Co. v. Ky. Glass-Works Co., 50 S. W. 2; 20 Ky. Law

⁴ *Downing v. Mt. Washington Road Co.*, 40 N. H. 230, 236 (semble).

doctrines of law applied in England and in this country to *ultra vires* contracts of corporations, a brief indication may be proper of certain classes of contracts which are distinguishable from mere *ultra vires* contracts.

In the first place, all merely irregular contracts must be placed on one side — contracts which the company has the power to make but in making which it has proceeded in a manner prohibited by its act of incorporation or other regulations.¹ Such contracts if ratified or authorized by the company itself — that is, the shareholders — will be binding. Moreover, even when entered into by the directors or other agents, such contracts will be binding if the other party had no notice of the irregularity. The case is assimilated to an agent's disregard of his principal's instructions as to the mode of exercise of the delegated authority. This is the rule in *Royal British Bank v. Turquand*.² Moreover, the provision prescribing a certain form or mode of contracting will often be construed as merely directory, so that non-compliance will not vitiate the contract even as regards a person who has notice of the irregularity.³

§ 1061. **Contracts proper in themselves but made for Ultra Vires Purpose.** — Secondly, contracts which although made for a purpose beyond the scope of the company's business are yet such as but for this unlawful intent the corporation might properly have made should be distinguished.⁴ Where the corporation has power to make a contract for certain purposes or upon the existence of certain facts which lie peculiarly within the company's own knowledge, such a contract although made for a different purpose or although all the required conditions of the exercise of the power did not exist, is nevertheless as regards any person who has no knowledge of the improper intent or of the non-existence of the required facts, not *ultra vires* but *intra*

¹ See *G. V. B. Mining Co. v. First Nat. Bank*, 95 Fed. 23, 33-35; 36 C. C. A. 633; *St. Joseph's Polish, etc. Soc. v. St. Hedwig's Church*, 53 Atl. 353; 4 Penn. (Del.) 141. All cases of contracts made in violation of the by-laws of an American corporation fall within this class.

² See *infra*, § 1473-§ 1476 and § 1289. Cf. § 732.

³ *Supra*, § 476 and § 491, and *infra*, § 1070. It is otherwise as to provisions limiting the powers of officers or agents of the company; such provisions create an incapacity, which, however, the shareholders may by unanimous action remove. *Ridley v. Plymouth Baking, etc. Co.*, 2 Ex. 711.

⁴ Cf. *supra*, § 1050.

vires.¹ These contracts are binding, even while purely executory, unless the opposite party had notice of the unlawful intent.² So, even by the rigorous English rule, the company's intention to divert borrowed money to *ultra vires* purposes will not constitute any defence to an action to recover the amount of the loan unless the lender had notice of the illegal intent at the time the loan was made.³ If at the time of making the

¹ The classic statement of this doctrine is found in Lord Campbell's judgment in *Mayor, etc. of Norwich v. Norfolk Ry. Co.*, 4 E. & B. 397, 443. Said that learned judge, "The mere circumstance of a covenant by directors in the name of the company being *ultra vires*, as between them and the shareholders, does not necessarily disentitle the covenantee to sue upon it. For example, if the directors of a railway company were to enter into a contract under the seal of the company for the purchase of a large quantity of iron rails and to pay for them at a fixed price, as the vendor had reasonable ground for supposing that the rails were wanted for the purpose of the railroad, it would be no defence to an action for the price, or for not accepting them, that the rails were illegally purchased on speculation, to be resold by the directors for their own profit. But suppose that the directors of a railway company should purchase a thousand gross of green spectacles, as a speculation, and should put the seal of the company to a deed covenanting to pay for these goods, here would be a clear excess of authority on the part of the directors; this excess of authority would necessarily be known to the covenantee; and he being *in pari delicto*, I conceive that the maxim would apply *potior est conditio defendentis*. This would be an illegal contract to misapply the funds of the company; and the illegality might be set up as a defence."

² *Eastern Counties Ry. Co. v.*

Hawkes, 5 H. L. Cas. 331; *Miners' Ditch Co. v. Zellerbach*, 37 Cal. 543; 99 Am. Dec. 300; *Colorado Springs Co. v. American Pub. Co.*, 97 Fed. 843, 849; 38 C. C. A. 433; *Lucas v. White Line Transfer Co.*, 70 Iowa 541, 546-547; 30 N. W. 771; 59 Am. Rep. 449 (semble).

Cf. *Sturdevant v. Farmers', etc. Bank*, 87 N. W. 156; 62 Nebr. 472; 95 N. W. 819; 69 Nebr. 220; *Underwood v. Newport Lyceum*, 5 B. Monr. (Ky.) 129; 41 Am. Dec. 260; *Brewer Brewing Co. v. Boddie*, 181 Ill. 622; 55 N. E. 49; *Lancaster v. Amsterdam Imp. Co.*, 140 N. Y. 576; 35 N. E. 964; 24 L. R. A. 322; *Tracy v. Talmage*, 14 N. Y. 162; 67 Am. Dec. 132 (holding knowledge of the improper purpose to be immaterial unless some act is done in furtherance thereof); *Curtiss v. Leavitt*, 15 N. Y. 1 (reaffirming doctrine of last case); *Coleridge Creamery Co. v. Jenkins*, 92 N. W. 123; 66 Nebr. 129 (no defence to suit by corporation for specific performance of a contract for the purchase of land that the land was not needed for corporate purposes).

See also *supra*, § 1050.

³ *David Payne & Co.* (1904), 2 Ch. 608. Accord: *Thompson v. Lambert*, 44 Iowa 239; *Bradley v. Ballard*, 55 Ill. 413; 8 Am. Rep. 656 (explained in *National Home Building Ass'n v. Home Sav. Bank*, 181 Ill. 35, 46-47; 54 N. E. 619; 64 L. R. A. 399; 72 Am. St. Rep. 245).

Cf. *Illinois, etc. Bank v. Pacific Ry. Co.*, 117 Cal. 332, 343; 49 Pac. 197 (holding that mere notice of the intention to divert the borrowed

contract, the other party did have knowledge of the company's intention, the contract should probably be placed in the category of ordinary *ultra vires* contracts.¹ For example, a railway company has undoubted power to purchase iron rails for its roadway; but if it should purchase rails not for actual use but for sale on speculation, it would act beyond its lawful powers. And if the vendor had notice of this intention, the contract like any other *ultra vires* contract would be unenforceable; but if the company's intent were not disclosed to the seller, the contract would be as absolutely binding as if the company's purpose had been to put the rails to a legitimate use.² Upon the same principle, where a corporation has power to issue promissory notes or other negotiable instruments, the fact that a note was executed as part of an *ultra vires* transaction will be no defence to an action by a holder for value without notice of that fact.³

money is immaterial if the lender did nothing to further that purpose); *Franklin Co. v. Lewiston Institution*, 68 Me. 43; 28 Am. Rep. 9 (holding that money paid for account of a corporation to a third person for property which the corporation had no power to hold cannot be recovered from the corporation); *Wright v. Hughes*, 119 Ind. 324; 21 N. E. 907; 12 Am. St. Rep. 412 (holding that lender's knowledge of company's purpose is immaterial as the contract has been fully executed on the lender's side); *Marion Trust Co. v. Crescent Loan, etc. Co.*, 61 N. E. 688; 27 Ind. App. 451 (mere knowledge of intent to divert money to *ultra vires* purpose held immaterial unless participated in by lender or made a condition of the loan).

But see *Durham County, etc. Bldg. Soc.*, 12 Eq. 516.

¹ Cf. *Coleman v. San Rafael, etc. Co.*, 49 Cal. 517; *Pacific R. R. Co. v. Seely*, 45 Mo. 212; 100 Am. Dec. 369; *Bank of Michigan v. Niles*, 1 Doug. (Mich.) 401; 41 Am. Dec. 575. See also cases cited in last note.

² See *supra*, p. 861, n. 1.

³ *Bird v. Daggett*, 97 Mass. 494; *Monument Nat. Bank v. Globe Works*, 101 Mass. 57; 3 Am. Rep. 322 (accommodation note); *Credit Co. v. Howe Machine Co.*, 54 Conn. 357; 8 Atl. 472; 1 Am. St. Rep. 123 (accommodation acceptance); *Webster v. Howe Machine Co.*, 54 Conn. 394; 8 Atl. 482 (same point); *Farmers' Nat. Bank v. Sutton Mfg. Co.*, 52 Fed. 191; 3 C. C. A. 1; 17 L. R. A. 595; *Gordon v. Sea Fire Life Ass. Soc.*, 1 H. & N. 599 (bill of exchange accepted in excess of limit fixed by deed of settlement); *Phoenix Life Ass. Co.*, 2 Johns. & H. 441 (headnote inadequate); *Wright v. Pipe Line Co.*, 101 Pa. St. 204; *Auerbach v. Le Sueur Mill Co.*, 28 Minn. 291; 9 N. W. 799; 41 Am. Rep. 285; *Mechanics' Banking Ass'n v. N. Y., etc. Lead Co.*, 35 N. Y. 505 (accommodation note); *National Bank of Republic v. Young*, 41 N. J. Eq. 531 (accommodation note); *Jacobs Pharmacy Co. v. Southern Banking, etc. Co.*, 97 Ga. 573; 25 S. E. 171 (accommodation note payable to company's own order); *Ex parte Estabrook*, 8 Fed. Cas. 794; 2 Lowell 547 (accommodation note); *Faneuil*

§ 1062. **Contracts disabling Public-Service Corporations from performing their public Duties.** — Another class of contracts which should be distinguished from mere *ultra vires* contracts are contracts which disable public-service companies from performing their public duties. The policy of the law may demand that these contracts even when executed should be held void and ineffective to pass title. For instance, the right of way of a railroad company is inalienable without legislative sanction; and the policy of the law may well be deemed to require that a contract by a railway company to sell or transfer such inalienable property, even when followed by delivery of a deed of conveyance and consummated by a transfer of possession, should nevertheless be held void, the title remaining in the corporation so as to enable it to continue its public functions. In that respect, such contracts may well be differentiated from mere *ultra vires* contracts involving no such question of public policy.¹ Nevertheless, contracts of this class are often assimilated to ordinary *ultra vires* contracts,² and indeed many of the leading cases in regard to *ultra vires* contracts, such as a number of those in the Supreme Court of the United States which have been already cited, have been cases of *ultra vires* railway leases. Although such contracts were capable of being distinguished from mere *ultra vires* contracts, that court did not proceed upon any such ground.

§ 1063. **Contracts tending to influence Public-Service Corporations improperly in Exercise of public Duties.** — Contracts tending to influence public-service corporations improperly in the

Hall Bank v. Bank of Brighton, 16 Gray (Mass.) 534 (drafts prohibited by statute); *Stouffer v. Smith-Davis Hardware Co.* (Ala.), 45 So. 621. See *infra*, § 1703, as to coupon bonds.

But see *Ætna Nat. Bank v. Charter Oak Life Ins. Co.*, 50 Conn. 167. Cf. *Nat. Park Bank v. German-American, etc. Co.*, 116 N. Y. 281; 22 N. E. 567; 5 L. R. A. 673 (endorsee charged with notice that company's endorsement of note was for accommodation merely); *J. G. Brill Co. v. Norton, etc. Street Ry. Co.*, 189 Mass. 431; 75 N. E. 1090 (similar point).

¹ *Visalia Gas, etc. Co. v. Sims*, 104 Cal. 326, 332; 37 Pac. 1042; 43 Am. St. Rep. 105 ("It is said, however, that when a contract which was *ultra vires* has been performed, the other is then estopped to plead that the contract was *ultra vires*. Here, however, the contract was void because against public policy. In such cases the courts will not give relief to either party").

² See *Bath Gas Light Co. v. Claffy*, 151 N. Y. 24; 45 N. E. 390; 36 L. R. A. 664; *Woodruff v. Erie Ry. Co.*, 93 N. Y. 609.

performance of their public duties, should also be distinguished from mere *ultra vires* contracts. Contracts by railway companies to give rebates and the like are of this class. So, also, according to some authorities are agreements by railway companies to construct the railway along a particular route or to build or refrain from building stations, sidings, bridges, etc., at particular points.¹ Where such contracts are deemed objectionable, they are not merely *ultra vires* but are contrary to public policy, because they tend to influence the company by considerations other than the public welfare and convenience. They would be equally objectionable if entered into by an individual who was engaged in a public calling.

§ 1064—§ 1070. *Contracts prohibited by Statute.*

§ 1064. **General Principle.** — Contracts prohibited by statute should now be considered. In these cases, the aim of the courts should be to apply such rules to the contracts in question as will best carry out the policy and purpose of the legislature in adopting the statute. "The statute must be examined as a whole, to find out whether or not the makers of it meant that a contract in contravention of it should be void."²

§ 1065. **Cases where Prohibited Contract is made Illegal in strict Sense.** — In the first place, the court may discern a legislative intent to make the contract in question illegal in the strictest sense, so as to be more analogous to contracts *mala in se* than to mere *ultra vires* contracts. In such cases the maxims *in pari delicto potior est conditio defendentis* and *ex turpi causa non oritur actio* will be applied. The contract will be regarded as so foul that a court of justice ought not to be concerned with it. Accordingly, no action will be maintainable either on the contract, or to recover back money or property parted with on the faith of it.³ And when the contract has been executed, the court

¹ See *Pacific R. R. Co. v. Seely*, *Corning State Savings Bank* (Iowa), 45 Mo. 212; 100 Am. Dec. 369, and 113 N. W. 500.

Wood on Railroads, 2d ed., § 184, § 274 a; Elliott on Railroads, 2d ed., § 362, § 385 et seq. ³ *Re Jaycox*, 12 Blatchf. 209 (adopting a different construction of New York banking laws from the

² *Harris v. Runnels*, 12 How. 79, construction adopted by the courts 84. Cf. *Dunlop v. Mercer*, 156 Fed. of that state in cases cited infra, 545, 556; *State ex rel. Carroll v.* p. 865, n. 2); *State ex rel. Carroll v.*

will not concern itself with restoring the parties to the *status in quo*, but will leave them where it finds them. Of this character, according to many authorities, is a contract by a foreign corporation made in violation of a statute prohibiting the transaction of business within the state without first performing certain statutory conditions.¹ It is, however, seldom that a court will take this extreme view.²

§ 1066. **Cases where Prohibited Contract is made wholly Void but not strictly Illegal.** — In the second place, the court may conclude that the policy of the legislative prohibition would be better effectuated by holding the forbidden contract to be — not immoral, foul, and illegal in the strict sense, but rather totally void — a mere nullity, devoid of legal consequences. In such cases, no action can be maintained by either party on the contract;³ and even when the agreement has been executed by the parties, the courts will attach no consequences to their acts. For

Corning State Savings Bank (Iowa), 113 N. W. 500.

¹ *Pittsburgh Const. Co. v. West Side Belt R. R. Co.*, 154 Fed. 929; *Cincinnati Mut., etc. Ass. Co. v. Rosenthal*, 55 Ill. 85; 8 Am. Rep. 626; *Neyens v. Worthington* (Mich.), 114 N. W. 404. See Beale on Foreign Corporations, § 214.

² Cf. *White v. Franklin Bank*, 22 Pick. (Mass.) 181 (where the court held that the contract was illegal as *malum prohibitum* but that the parties were not *in pari delicto* and that therefore money parted with under the contract might be recovered back); *Pratt v. Short*, 79 N. Y. 437; 35 Am. Rep. 531 (where the court took a similar view of a statute prohibiting unauthorized banking, which statute has also been construed in *New York State, etc. Trust Co. v. Helmer*, 77 N. Y. 64; *Tracy v. Talmage*, 14 N. Y. 162; 67 Am. Dec. 132; *Curtiss v. Leavitt*, 15 N. Y. 1); *Southern Loan Co. v. Morris*, 2 Pa. St. 175; 44 Am. Dec. 188 (promissory note issued by corporation in defiance of statutory prohibition not enforceable against endorser).

An act of incorporation provid-

ing that the company might charge interest at a rate not exceeding six per cent per annum was held merely to place the corporation on the same footing, as to usury, as individuals so that where by the general law the principal and legal interest are recoverable on usurious loans, this corporation having made an usurious loan should have the same right; *Philadelphia Loan Co. v. Towner*, 13 Conn. 249. For other cases in which statutes limiting the rate of interest which corporations may charge have been construed to subject contracts for excessive interest to the same rules as by the general law govern usurious contracts, see *Rock River Bank v. Sherwood*, 10 Wisc. 230; 78 Am. Dec. 669; *McLean v. Lafayette Bank*, 3 McLean 587; *Commercial Bank v. Nolan*, 7 How. (Miss.) 508 (a strong case).

³ Cf. *Assignment Mut., etc. Ins. Co.*, 107 Iowa 143; 77 N. W. 868; 70 Am. St. Rep. 149 (contract of insurance made by mutual company with a non-member for a fixed premium in violation of statutory prohibition declared to be void).

instance, a deed in pursuance of such a contract will pass no title.

§ 1067. **Cases where Prohibited Contract is binding although Parties are subjected to Penalty.** — Thirdly, the object of the statute may be such that the contract should be valid and binding *inter partes*, the effect of the prohibition being merely to subject one or both of the parties to some penalty.¹ For instance, an Act of Congress providing that the liabilities of a national bank to any one person or firm should at no time exceed one-tenth of the paid-up capital does not prevent a bank recovering a sum of money exceeding that amount lent to one person in violation of the statute.² So, a statute forbidding a bank to lend money to one of its officers does not have the effect of preventing the bank from recovering money lent in disregard of the prohibition.³ In all such cases, the prohibition is intended for the benefit of the corporation, and cannot be perverted to the company's injury. So, also, according to some authorities, a statute forbidding foreign corporations to transact business within the state without complying with certain conditions merely subjects to a penalty a corporation which enters into a contract before complying with the statute, and does not make the contract illegal or unenforceable.⁴

§ 1068. **Cases where Statute makes Prohibited Contract merely Ultra Vires.** — Fourthly, the effect of the statutory prohibition may be merely to restrict the capacity of the corporation — in other words, to make the prohibited contract *ultra vires* merely, and subject to the same rules as to enforceability *vel non* as other

¹ Cf. *Thompson v. St. Nicholas Bank*, 29 Fed. 734; *Shoemaker v. Nat. Bank*, 146 U. S. 240; 13 Sup. Ct. 66 (construing the section of the National Bank Act which prohibits banks from certifying cheques unless the drawer has on deposit an amount equal to the face value of the cheque); *Oneida Bank v. Ontario Bank*, 21 N. Y. 490 (statute prohibiting time drafts upon banking associations). But see *E. Swindell & Co. v. Bainbridge State Bank* (Ga.), 60 S. E. 13 (adopting a different construction of a similar state statute).

² See *infra*, § 1605.

³ *Gold Mining Co. v. National Bank*, 96 U. S. 640; *Shoemaker v. Nat. Mechanics' Bank*, 2 Abb. (U. S.) 416; *Maryland Trust Co. v. Nat. Mechanics' Bank*, 102 Md. 608, 613; 63 Atl. 70; *Wyman v. Citizens' Nat.* v. *Am. Bridge Co.*, 151 Fed. 871; *Sherwood v. Alvis*, 83 Ala. 115; *Dunlop v. Mercer*, 156 Fed. 545. See also Beale on Foreign Corporations, § 213.

ultra vires contracts.¹ For instance, this is the effect of a general enactment that a corporation shall make no contracts or exercise no powers except such as are incidental to the purposes of its creation.² So, the implied prohibition against borrowing money on security of real estate, which is found in the National Bank Act, seems to have this effect merely.³ According to some authorities, the same would be true of a statute limiting the amount of indebtedness which a corporation may contract.⁴

§ 1069. **Cases where Statute merely prescribes a Rule of Indoor Management.** — It should never be forgotten that the statutory prohibition may be of such a character as merely to prescribe a rule of "indoor management," so that under the rule in *Royal British Bank v. Turquand*, a contract with a stranger to the company made in violation of the regulation will nevertheless be valid unless the outsider be affected with notice of the irregularity.⁵

§ 1070. **Cases where Statute is Directory merely.** — Moreover, in some cases the statute may be construed as directory merely, — that is to say, as laying down a rule proper to be observed but without annexing any penalty to a violation.⁶ This seems

¹ Cf. *White v. Franklin Bank*, 1127 (headnote inadequate); *State* 22 Pick. (Mass.) 181; *Tracy v. v. Consolidation Coal Co.*, 46 Md. 1, 14 N. Y. 162; 67 Am. 9 (where such a statute was said Dec. 132 (approved in *Curtiss v. to be "merely declaratory")*). Cf. *Leavitt*, 15 N. Y. 1; *Pixley v. Butterworth v. Kritzer Milling Co.*, 33 Cal. 183, 115 Mich. 1; 72 N. W. 990. (construing a statute enacting that "no contract shall be binding on the company unless made in writing"). See also other cases cited supra, § 476.

² *Bond v. Terrell, etc. Mfg. Co.*, 82 Tex. 309; 18 S. W. 691; *Marshall Nat. Bank v. O'Neal*, 11 Tex. Civ. App. 640; 34 S. W. 344 (holding that such a statute does not invalidate accommodation note in hands of *bona fide* purchaser); *Farmers' Nat. Bank v. Sutton Mfg. Co.*, 52 Fed. 191 (similar point to last case, the statute being held merely declaratory of the common law); *Chenoweth v. Pacific Express Co.*, 93 Mo. App. 185, 194-195, 197 (headnote inadequate); *Harris v. Independence Gas Co.* (Kans.), 92 Pac. 1123, 1125.

³ *National Bank v. Whitney*, 103 U. S. 99. Cf. *Weber v. Spokane Nat. Bank*, 64 Fed. 208; 12 C. C. A. 93 (stated infra, p. 1408); *First Nat. Bank v. Grosshans*, 61 Nebr. 575; 85 N. W. 542.

⁴ *Beach v. Wakefield*, 107 Iowa 567; 76 N. W. 688; 78 N. W. 197. Cf. supra, § 118.

⁵ Supra, § 1060, and infra, § 1473, § 1475.

⁶ In many cases in regard to the contracts of corporations, the word "directory" is used with reference to requirements, violation of which is cause for terminating the corporate existence at the suit of the state but does not effect the validity of the contracts *inter partes*. In other words, the term is used to

to be the construction which has been adopted of a section of the National Bank Act, providing that no national bank shall incur indebtedness in excess of its capital stock except for deposits, etc.¹ The same has been held with reference to a statute providing that no loan shall be made by a savings bank "on security of names alone."² Indeed, the courts should lean towards this construction of any merely regulatory statute prescribing the method of conducting the business of the corporation.³ In many cases the same result would be reached whether the statute is construed as merely directory or whether the statutory prohibition is deemed to make the forbidden act *ultra vires*; and it is therefore often difficult to determine upon which of these grounds a decision proceeds.

§ 1071. **Illegal or immoral Contracts in Intra Vires Business.** — Illegal or immoral contracts of corporations entered into in the course of an *intra vires* business are governed by precisely the same rules as similar contracts made by an individual.⁴ The argument that no corporation is formed to violate the law and that therefore the contracts in question are *ultra vires* and should be governed by the rules applicable to *ultra vires* contracts will not be allowed to prevail. This question has generally arisen in regard to contracts for excessive interest, where a limit is fixed

designate the class of contracts referred to in a former paragraph. Conn. 181; 9 Am. Rep. 375. Cf. supra, § 476.

¹ *Gold Mining Co. v. Nat. Bank*, 96 U. S. 640; *Weber v. Spokane Nat. Bank*, 64 Fed. 208; 12 C. C. A. 93. Cf. *Ossipee, etc. Mfg. Co. v. Canney*, 54 N. H. 295; *Connecticut River Sav. Bank v. Fiske*, 60 N. H. 363.

² *Farmington Sav. Bank v. Fall*, 71 Me. 49. Cf. *Mutual Life Ins. Co. v. Wilcox*, 8 Biss. 203.

³ *Southern Life, etc. Co. v. Lanier*, 5 Fla. 110; 58 Am. Dec. 448; *Dayton Ins. Co. v. Kelly*, 24 Oh. St. 345; 15 Am. Rep. 612. But see *Couch v. City Fire Ins. Co.*, 38

In some cases, this rule has been expressed by saying that contracts within the general scope of company's authority but in excess of its lawful powers are valid. *German-town, etc. Ins. Co. v. Dhein*, 43 Wisc. 420; 28 Am. Rep. 549; *Littlewort v. Davis*, 50 Miss. 403.

⁴ *Rock River Bank v. Sherwood*, 10 Wisc. 230; 78 Am. Dec. 669; *McLean v. Lafayette Bank*, 3 McLean 587, 611; *Commercial Bank v. Nolan*, 7 How. (Miss.) 508 (a strong case); *Chicago, etc. Ry. Co. v. Southern Indiana Ry. Co.* (Ind.), 70 N. E. 843.

by statute (which should be construed as a usury law) to the amount of interest which a corporation may charge.¹

§ 1072. **Ultra Vires Torts.** — The law respecting the liability of business corporations for *ultra vires* torts is involved in somewhat less confusion than the law of *ultra vires* contracts. In one sense, every tort is *ultra vires*; for no corporation is formed for the purpose of committing wrongs against the person or property of others. But the law is clearly settled that a corporation is not exempted from liability *ex delicto*. On the contrary, for all torts committed in the course of an *intra vires* business, the company is liable to the same extent as an individual would be.² In England, the rule seems to be that no liability attaches to a corporation formed under a general or special act of Parliament for torts committed in the course of an *ultra vires* business.³ The American cases generally go further and hold that even when a corporation assumes to engage in some *ultra vires* business, liability will attach to the company for torts committed in the course of that business.⁴ In other words, the only application

¹ See cases cited in last note, and *Danforth v. Nat. State Bank*, 48 Fed. 271 (note acquired by usurious discounting); *Nat. Bank v. Johnson*, 104 U. S. 271; *George N. Fletcher & Sons v. Alpena Circuit Judge* (Mich.), 99 N. W. 748 (usurious contract of corporation not, properly speaking, *ultra vires*, but enforceable unless debtor pleads usury).

² *Yarborough v. Bank of England*, 16 East 6 (trover against royal charter corporation); *Maund v. Monmouthshire Canal Co.*, 4 Man. & Gr. 452 (trespass against company incorporated by special act); *Eastern Counties Ry. Co. v. Broom*, 6 Exch. 314 (assault and false imprisonment); *Green v. London General Omnibus Co.*, 7 C. B., N. S., 290 (malicious interference with plaintiff's business); *Philadelphia, etc. Ry. Co. v. Quigley*, 21 How. 202 (libel); *Chestnut Hill, etc. Co.*

Rutter, 4 Serg. & R. (Pa.) 6; 8 Am. Dec. 675 (case for stopping a water-course); *Erie City Iron Works v. Barber*, 106 Pa. St. 125; 51 Am. Rep. 508 (deceit); *Hussey v. Norfolk, etc. R. R. Co.*, 98 N. Car. 34; 3 S. E. 923; 2 Am. St. Rep. 312 (malicious prosecution).

As to whether charitable corporations are similarly liable, see *University of Louisville v. Hammock* (Ky.), 106 S. W. 219; *Perry v. House of Refuge*, 63 Md. 20; 52 Am. Rep. 495, and cases cited.

³ Brice on *Ultra Vires*, 3d ed., 435.

⁴ *Central R. R., etc. Co. v. Smith*, 76 Ala. 572; 52 Am. Rep. 353; *Lucas v. White Line Transfer Co.*, 70 Iowa 541, 547; 30 N. W. 771; 59 Am. Rep. 449 (semble); *Bissell v. Michigan Southern R. R. Co.*, 22 N. Y. 258 (liability for negligent injury to a passenger); *Hutchinson v.*

of the doctrine of *ultra vires* to liability of corporations *ex delicto* is in showing that the alleged tortious act was not committed within the scope of authority of the officer or agent who was at fault.¹ The few cases that apparently deny liability for torts committed in an *ultra vires* business can generally be explained on the ground that the conduct of the *ultra vires* business was beyond the authority conferred by the corporation on the agents who engaged therein. Other American cases which exempt corporations from liability for *ultra vires* torts may be explained, and perhaps supported, on the ground that the torts in question were so intimately connected with an *ultra vires* contract that an action nominally for the tort would be in substance almost equivalent to an action on the contract.² For example, in a Maryland case, a corporation was exonerated from liability for deceit practised in inducing a third person to enter into an *ultra vires* contract with the company.³

Western, etc. R. R. Co., 6 Heisk. (Tenn.) 634; *New York, Lake Erie, etc. Ry. Co. v. Haring*, 47 N. J. Law 137; 54 Am. Rep. 123 (wrongful ejection from street railway car); *Gruber v. Washington, etc. R. R. Co.*, 92 N. Car. 1 (negligent injury to passenger); *South & North Ala. R. R. Co. v. Chappell*, 61 Ala. 527; *Zinc Carbonate Co. v. First Nat. Bank*, 103 Wis. 125; 79 N. W. 229; 74 Am. St. Rep. 845 (conspiracy to defraud); *Buffett v. Troy, etc. R. R. Co.*, 40 N. Y. 168 (negligent injury to passenger); *Merchants' Bank v. State Bank*, 10 Wall. 604, 645 (semble, "Corporations are liable for every wrong of which they are guilty, and in such cases the doctrine of *ultra vires* has no application"); *Nat. Bank v. Graham*, 100 U. S. 699 (negligence by bailee); *Metropolitan Stock Exchange v. Lyndonville Nat. Bank*, 57 Atl. 101, 103; 76 Vt. 303 (semble).

But see *Bathe v. Decatur County Agricultural Soc.*, 73 Iowa 11; 34 N. W. 484; 5 Am. St. Rep. 651; *Gillett v. Missouri Valley R. Co.*, 55 Mo. 315, 323-324; 17 Am. Rep. 653 (holding that action for mali-

cious institution of criminal prosecution is not maintainable, and perhaps supportable on the ground that the agent of the corporation exceeded his authority in instituting the prosecution — a decision with which *Alexander v. Relfe*, 74 Mo. 495, should be compared). The rule stated in the text does not apply to municipal corporations. 2 Dillon on Mun. Corps., 4th ed., § 968. Cf. *Salt Lake City v. Hollister*, 118 U. S. 256, 263; 6 Sup. Ct. 1055 (where in a case relating to a municipal corporation the court clearly pointed out the distinction between liability *ex delicto* and *ex contractu* growing out of *ultra vires* transactions).

¹ *Central R. R., etc. Co. v. Smith*, 76 Ala. 572; 52 Am. Rep. 353.

Cf. *Gillett v. Missouri Valley R. Co.*, 55 Mo. 315, 323-324; 17 Am. Rep. 653.

² Cf. *Gunn v. Central R. R.*, 74 Ga. 409 (action for tort consisting in breach of duty arising from a contract of an *ultra vires* partnership contracted by company).

³ *Weckler v. First Nat. Bank*, 42 Md. 581; 20 Am. Rep. 95.

CHAPTER XVII

ONE-MAN COMPANIES

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§ 1073. **Corporations Sole — Modern One-Man Companies.** — The ancient law divided corporations into two classes, — corporations sole and corporations aggregate.¹ Corporations sole in this sense are obsolete in the United States, or at any rate are so rare and so different from the ordinary business or mercantile joint-stock corporation that they may be regarded for present purposes as a negligible factor in the law. On the other hand, modern conditions have given rise to a new kind of corporations, which might not inaptly be called corporations sole if that term

¹ 1 Black. Comm. 469.

had not been appropriated to designate the class of corporations above referred to, and which in fact have been rather aptly called "one-man companies"¹ — that is to say, corporations which have been formed in theory upon the ordinary plan of corporations aggregate, but in which *one man* has acquired either the entire interest or a largely predominating interest.

§ 1074. **Scheme of Treatment.** — These one-man companies may be subdivided into two classes.² The first consists of companies which were organized with the expectation that they would be composed of an aggregation of individuals and without any expectation that one person should acquire practically the entire capital stock, but in which eventually one man has come to own all, or virtually all, the shares. The second class comprises corporations which are formed for the very purpose of being owned by one man and in which no other person is expected to have more than a nominal interest. We shall therefore first consider the general principles of law applicable to any case in which one man has come to own all, or virtually all, of the shares; and subsequently the peculiar problems relating to incorporation for the deliberate purpose of organizing a one-man company will be dealt with.

§ 1075-§ 1083. COMPANIES FORMED WITHOUT INTENT THAT
ONE PERSON SHOULD ACQUIRE ENTIRE INTEREST.

§ 1075-§ 1080. *Ownership by one Person of literally all
outstanding Shares.*

§ 1075. **Doctrine that Corporate Existence is terminated or suspended.** — As to cases where one man has acquired literally all the outstanding shares several views have been propounded. In the first place, in an early case, Chancellor Bland of Maryland expressed *obiter* the opinion that the purchase by one individual of all the shares in a corporation aggregate would *ipso*

¹ "It has become the fashion to call companies of this class 'one-man companies.' That is a taking nickname, but it does not help one much in the way of argument." Per Lord Macnaghten in *Salomon v. Salomon & Co.* (1897), A. C. 22, 53.

² As to this classification, see *Louisville Banking Co. v. Eisenman*, 94 Ky. 83, 93-94; 21 S. W. 531, 1049; 42 Am. St. Rep. 335; 19 L. R. A. 684.

facto dissolve the corporation so as to prevent the maintenance of an action or suit in the corporate name.¹ In a later Maryland case the qualification was added that such a sole owner may dispose of some of his shares to other persons and so revive the corporate organization, but the doctrine was approved that the ownership by one person of the company's entire capital does, while such ownership continues, "suspend corporate action."² The fact that the transfer of some of the shares to the owner of the others had not been entered on the company's books, although the certificates had been delivered to him endorsed in blank, was thought not to prevent this suspension of corporate functions.³

§ 1076. **The contrary Doctrine.** — But the prevalent, and it is submitted the sounder, view is that even the ownership by one individual of all the capital of a corporation has no effect whatever on the corporate existence;⁴ that the corporation and the owner of the capital stock continue to be distinct legal entities, and that the only way the property or business of the corporation can *regularly* be carried on by the sole shareholder without

¹ *Bellona Company's Case*, 3 Co., 20 Conn. 447; *Mathis v. Morgan*, 72 Ga. 517, 525-526; 53 Am. Rep. 847; *Winona, etc. R. R. Co. v. St. Paul, etc. R. R. Co.*, 23 Minn. 359;

² *Swift v. Smith*, 65 Md. 428; 5 Atl. 534; 57 Am. Rep. 336.

Cf. *Louisville Banking Co. v. Eisenman*, 94 Ky. 83; 21 S. W. 531, 1049; 42 Am. St. Rep. 335; 19 L. R. A. 684 (intimating, *obiter*, that the corporate property would be liable for the individual debts of the sole shareholder, and that subsequent purchasers of shares would take in subordination to the claims of such creditors); *Re Bauernschmidt's Estate*, 97 Md. 35; 54 Atl. 637 (where an assignment of all the stock and some of the property of a corporation was held to leave the title to the remainder of the property in the sole stockholder).

³ *Swift v. Smith*, 65 Md. 428, 435-436 (headnote inadequate); 5 Atl. 534; 57 Am. Rep. 336.

As to a case where some of the shares are pledged to a third person, see *Wagner v. Marple*, 10 Tex. Civ. App. 505; 31 S. W. 691.

⁴ *Evarts v. Killingsworth Mfg.*

Co., 20 Conn. 447; *Mathis v. Morgan*, 72 Ga. 517, 525-526; 53 Am. Rep. 847; *Winona, etc. R. R. Co. v. St. Paul, etc. R. R. Co.*, 23 Minn. 359; *Newton Mfg. Co. v. White*, 42 Ga. 148; *Commonwealth ex rel. Attorney-General v. Monongahela Bridge Co. (Pa.)*, 64 Atl. 909 (holding that the ownership of all the shares by a municipal corporation is no reason for dissolving the company at the instance of the state); *Monongahela Bridge Co. v. Pittsburgh, etc. Traction Co.*, 196 Pa. St. 25; 46 Atl. 99; 79 Am. St. Rep. 685; *Rhawn v. Edge Hill Furnace Co.*, 201 Pa. 637; 51 Atl. 360; *Exchange Bank v. Macon Construction Co.*, 97 Ga. 1; 25 S. E. 326; 33 L. R. A. 800; *Goulburn Valley Butter, etc. Co. v. Bank of New South Wales*, 26 Vict. L. R. 351.

Cf. *Russell v. McLellan*, 14 Pick. (Mass.) 63 (where two persons divided the capital stock of a corporation between them); *Wilde v. Jenkins*, 4 Paige (N. Y.) 481 (where the purchase was made by a firm).

corporate formalities is by pursuing the procedure provided by law for the dissolution and winding-up of corporations aggregate.¹ While this doctrine may seem to some modern minds to savor of mediæval technicalities, yet it is the only rule which harmonizes with the theory of the law; it obviates many knotty legal problems, and in the long run more nearly accomplishes absolute justice than any other rule.

Accordingly, where one person acquires the entire capital of a corporation, he is not individually liable upon debts contracted by him in the corporate name;² nor is he liable individually for judgments rendered against the corporation.³ Actions and suits are still properly brought in the name of the corporation⁴ and not in the name of the sole shareholder;⁵ and conversely actions may still be maintained against the corporation.⁶ Moreover, action that is *ultra vires* of the corporation does not bind the corporate entity although carried out by the sole shareholder.⁷

§ 1077. *Limits of this Doctrine.* — This doctrine that the owner of the entire capital stock of a corporation can regularly act only through corporate formalities does not imply that action taken without such formalities must necessarily be null and void.⁸ For example, the legal title to the corporation's real estate could only pass by a deed in the corporate name and under the corporate seal; but a deed in the name of the sole stock-

¹ Cf. *First Nat. Bank v. Winchester*, 119 Ala. 168, 172-173; 24 So. 351; 72 Am. St. Rep. 904; *Fitzgerald v. Missouri Pac. Ry. Co.*, 45 Fed. 812.

But see *Wagner v. Marple*, 10 Tex. Civ. App. 505; 31 S. W. 691 (sale by sole shareholder of all the corporate property to himself in consideration of surrender of his shares held sufficient to pass legal title).

² *Louisville Banking Co. v. Eisenman*, 94 Ky. 83; 21 S. W. 531, 1049; 19 L. R. A. 684; 42 Am. St. Rep. 335.

Cf. *East St. Louis Connecting Ry. Co. v. Jarvis*, 92 Fed. 735, 741; *Donovan v. Purtell*, 216 Ill. 629; 75 N. E. 334; *Waycross, etc. R. R. Co. v. Offerman, etc. R. R. Co.*, 109 Ga. 827; 35 S. E. 275.

³ *Tilley v. Coykendall*, 69 N. Y. App. Div. 92; 74 N. Y. Supp. 631.

⁴ *Winona, etc. R. R. Co. v. St. Paul, etc. R. R. Co.*, 23 Minn. 359.

⁵ *Button v. Hoffman*, 61 Wisc. 20; 20 N. W. 667; 50 Am. Rep. 131 (replevin not maintainable by sole shareholder for chattels belonging to the corporation).

⁶ *Newton Mfg. Co. v. White*, 42 Ga. 148. Cf. *Sparks v. Dunbar*, 102 Ga. 129; 29 S. E. 295 (as to mechanics' lien proceedings).

⁷ *Goulburn Valley Butter, etc. Co. v. Bank of New South Wales*, 26 Vict. L. R. 351 (holding that a bank must make good to the corporation sums transferred from its account on the order of the sole shareholder to the latter's account then overdrawn). See also *infra*, § 1290.

⁸ See *infra*, § 1290-§ 1293.

holder might confer an equitable right.¹ Moreover, in some cases, *ex necessitate*, different rules must be applied to a one-man corporation of this kind. For instance, service of process on the sole shareholder would be good although he is not an officer.²

§ 1078. **Corporate Fiction no Cover for Fraud of Sole Shareholder.** — In any case where the sole stockholder attempts to use the corporate fiction as a cover for fraud, a court — at all events, a court of equity — would brush aside all forms and defeat the attempt, just as a court of equity will always look behind and disregard the corporate fiction, even though the company be composed of never so many shareholders, if such action is necessary to prevent the successful consummation of a fraud.³ For example, where the owners of all the shares of a corporation assign their shares to a single person for the purpose of leaving no qualified officer upon whom process in an anticipated suit could be served, the court will not suffer the fraudulent device to succeed, but will treat as valid service upon the former officers.⁴

It goes without saying that the owner of all the shares in a corporation cannot transfer the property to himself in fraud of the creditors of the corporation, but as to any such creditors the transfer is null and void.⁵ But it would seem that a mortgage from the corporation to the equitable owner of all its shares is subject to no presumption of invalidity.⁶

§ 1079. **Transfer of Shares or Bonds by Sole Shareholder.** — Where the owner of all the shares in a company sells his shares without disclosing that he holds a claim against the corporation, the purchaser may in equity enjoin him from maintaining an action at law upon the claim against the corporation.⁷ But, on the other hand, the owner of all the shares does not by making such a contract warrant the title of the company to its property,

¹ See *infra*, § 1292, § 1293.

But see *Baldwin v. Canfield*, 26 Minn. 43; 1 N. W. 261, 276 (stated, *infra*, § 1293).

² *Evarts v. Killingsworth Mfg. Co.*, 20 Conn. 447, 457 (semble). But see *Sparks v. Dunbar*, 102 Ga. 129 (stated *infra*, p. 878, n. 1).

³ *Meily v. London, etc. Fire Ins. Co.*, 148 Fed. 683; 79 C. C. A. 454 (fraud of sole shareholder in setting fire to property belonging to corpora-

tion a defence to action by the company on fire insurance policy). Cf. *infra*, § 1089.

⁴ *Evarts v. Killingsworth Mfg. Co.*, 20 Conn. 447.

⁵ *Moffat v. Smith*, 101 Fed. 771; 41 C. C. A. 671.

⁶ Cf. *Hanchett v. Blair*, 100 Fed. 817, 823-824; 41 C. C. A. 76.

⁷ *Given v. Times-Republican Printing Co.*, 114 Fed. 92; 52 C. C. A. 40.

and hence the vendee cannot rescind the agreement for failure of consideration even though the title of the corporation be in fact bad.¹ Moreover, it seems that a sole shareholder who sells certain bonds issued by the corporation is not estopped from setting up a claim on coupons which he had previously served from the bonds, where the transferee knew that the coupons had not been paid.² And where one company which owns all the shares in two distinct corporations transfers all the shares in one of the corporations, the rights of the other corporation are not affected by the transfer, so that the transferee cannot enjoin it from revoking a license previously granted to the former corporation.³

§ 1080. **Ownership by a Corporation of all the Shares in another Corporation.** — The acquisition by one corporation of all the shares in another corporation has been thought to partake of the nature of a temporary consolidation so long as such ownership continues.⁴ Hence, the dominant company may guarantee bonds issued by the subordinate company;⁵ for although a corporation has ordinarily no power to guarantee the bonds of another company, yet in this peculiar case, by reason of the peculiar relationship between the two companies, the guarantor company is regarded as doing little more than guaranteeing its

¹ *Fitzgerald v. Missouri Pacific Ry. Co.*, 45 Fed. 812 (headnote inadequate).

² *Cf. Rhawn v. Edge Hill Furnace Co.*, 201 Pa. 637, 644; 51 Atl. 360 (where the transferor owned all of the bonds and all except a few shares of the stock of the corporation).

³ *Coal Belt Electric Ry. Co. v. Peabody Coal Co.* (Ill.), 82 N. E. 627.

⁴ *Tod v. Kentucky Union Ry. Co.*, 57 Fed. 47; 6 C. C. A. 685 (affirmed in *Marbury v. Kentucky Union Land Co.*, 62 Fed. 335; 10 C. C. A. 393).

Cf. Guaranty Trust Co. v. Atlantic Coast Electric R. R. Co., 138 Fed. 517; 71 C. C. A. 41; *City of Louisville v. Louisville Water Co.*, 26 Ky. Law Rep. 425; 81 S. W. 698 (where a municipal corporation owned all the shares of a water company); *Gamewell, etc. Co. v. Fire & Police,*

etc. Co., 116 Ky. 759; 76 S. W. 862 (where the dominant corporation was held subject to a statutory liability as shareholder in a corporation of which it owned the entire capital stock); *Anderson v. War Eagle, etc. Co.*, 72 Pac. 671; 8 Idaho 759; *Sabre v. United Traction, etc. Co.*, 156 Fed. 79 (stated *infra*, § 1176).

Aliter where the dominant company acquires a mere majority of the shares of the subordinate company: *Louisville, etc. Ry. Co. v. Louisville Trust Co.*, 174 U. S. 552, 567-568; 19 Sup. Ct. 817 (semble).

⁵ *Tod v. Kentucky Union Ry. Co.*, 57 Fed. 47; 6 C. C. A. 685 (affirmed in *Marbury v. Kentucky Union Land Co.*, 62 Fed. 335; 10 C. C. A. 393).

Cf. New York Car Wheel Works, 141 Fed. 430.

own bonds. Somewhat inconsistent, however, with this reasoning is the decision rendered by the same court in the same case that the dominant company has power to guarantee the payment of a perpetual dividend at a certain rate on the shares of the subordinate company;¹ for it will be remembered that a corporation has no power to guarantee the payment of a dividend on its own shares.²

The fact that a purely private company owns all the shares in a railway company does not destroy the character of the latter company as a quasi-public corporation, and hence does not affect its right to condemn lands for railway uses.³ Conversely, the fact that a municipal corporation has acquired all the shares in a water company or other private corporation does not make the property of the latter corporation public property exempt from taxation.⁴

Indeed, in a suit by a railway corporation, an averment in the answer that all the shares in the complaining company are owned by another corporation has been stricken out as irrelevant and impertinent.⁵ Moreover, where a statute provided for the confiscation of land acquired by a corporation without due authority either "directly in the corporate name or through any trustee or other device whatsoever," it was held that land owned by one corporation which was duly authorized to hold it, but all of whose shares were owned by another corporation not so authorized, was not liable to escheat.⁶ A claim to recover money which is lent to a corporation owning all the shares in a railway company and which is applied in payment of operating expenses, has no priority, it has been held, over mortgage bonds previously issued by the railroad corporation, even though the

¹ *Tod v. Kentucky Union Ry. Co., Bridge Co. (Pa.)*, 64 Atl. 909; 57 Fed. 47, 62; 6 C. C. A. 685 *Monongahela Bridge Co. v. Pittsburgh, etc. Traction Co.*, 196 Pa. 25; (affirmed in *Marbury v. Kentucky Union Land Co.*, 62 Fed. 335, 10 46 Atl. 99; 79 Am. St. Rep. 685. C. C. A. 393).

² See *supra*, § 543.

³ *Ulmer v. Lime Rock R. R. Co.*, 98 Me. 579, 593-595; 57 Atl. 1001; 66 L. R. A. 387.

⁴ *Bell v. City of Louisville (Ky.)*, 106 S. W. 862. As to the ownership by a municipal corporation of all the shares of a bridge company, see *Commonwealth v. Monongahela*

As to the case where the state is the sole stockholder in a corporation, see *Curran v. Arkansas*, 15 How. 304; *Hutchinson v. Western, etc. R. R. Co.*, 6 Heisk. (Tenn.) 634.

⁵ *Winona, etc. R. R. Co. v. St. Paul, etc. R. R. Co.*, 23 Minn. 359.

⁶ *Commonwealth v. New York, etc. R. R. Co.*, 132 Pa. St. 591; 19 Atl. 291; 7 L. R. A. 634

circumstances be such that, under the doctrine of *Fosdick v. Schall*, a preference would have been allowed if the money had been lent to the railway company directly.¹

The ownership by a domestic company of all the shares in a foreign corporation does not necessarily make the business of the foreign company the business of the domestic company, so as to render the domestic company assessable under an income tax law for the full amount of the profits of the foreign company.² Conversely, a foreign company which owns the entire capital stock of another corporation is not necessarily deemed to be carrying on business in any state in which the subsidiary company may carry on business, so as to be suable in the courts of that state.³

Where the law provides that only shareholders may be directors and that the loss by a director of his qualification shares shall vacate the office, the acquisition by one corporation of all the shares of another company necessarily ousts all the directors of the second company and prevents, for the time being at least, the election of any qualified successors, and thus precludes corporate action in the ordinary mode.⁴

§ 1081-§ 1083. *Ownership by one Person of almost all or virtually all of the Shares.*

§ 1081. **In general.**—The acquisition by one person of a mere majority, however large, of the shares of a corporation would not be held by any court to dissolve the company or sus-

¹ *Exchange Bank v. Macon Construction Co.*, 97 Ga. 1; 25 S. E. 326; N. E. 1057.

33 L. R. A. 800. Cf. *Sparks v. Dunbar*, 102 Ga. 129; 29 S. E. 295 (mechanics' lien on property of railway company for materials, etc., used on its line not acquired by service of notice, etc., on the sole shareholder).

² *Gramophone & Typewriter v. Stanley* (1906), 2 K. B. 856.

Cf. *Apthorpe v. Peter Schoenhofen Brewing Co.*, 80 L. T. 395; *St. Louis Breweries v. Apthorpe*, 79 L. T. 551; *Bartholomay Brewing Co. v. Wyatt* (1893), 2 Q. B. 499; *People v. Am.*

Bell Tel. Co., 117 N. Y. 241; 22

³ *Conley v. Mathieson Alkali Works*, 190 U. S. 406 (headnote inadequate); 23 Sup. Ct. 728; *Peterson v. Chicago, Rock Island & Pac. Ry. Co.*, 205 U. S. 364 (where the foreign corporation owned all the shares of a domestic company except the shares necessary to qualify the directors, which were nominally outstanding).

⁴ *O'Connor v. International Silver Co.* (N. J.), 62 Atl. 408 (headnote inadequate).

pend corporate activity.¹ Probably, if even a single share were outstanding in the hands of some other owner, no court would hold the corporation *ipso facto* dissolved or suspended. Theoretically, such concentration of substantially all the shares under one ownership is attended by no legal consequences whatsoever. For example, the predominant shareholder who does not personally carry on the business of the corporation is not liable individually for the torts or obligations of the company.² The corporation runs on as before; and the courts will not deliberately and avowedly disregard the corporate fiction except in cases where they would do so if no one person owned a controlling interest in the company. To be sure, the fact that one man dominates the corporation will make the courts more disposed to look behind the corporate fiction and to treat the shareholders as, virtually, the corporation itself.³ The great difficulty in drawing the line between what is and what is not ownership of substantially all the shares is the strongest reason for adhering strictly to the rule that the corporate fiction cannot be disregarded, where one man owns substantially but not literally all the shares, except in cases where the fiction would be brushed aside even if the shares were scattered among various owners.

§ 1082. **Authority of predominant Shareholder as an Officer.** —

The fact that one man owns nearly all the shares in a corporation is a circumstance to be considered in determining the ex-

¹ Cf. *Kodak, Ltd. v. Clark* (1903), 1 K. B. 505 (where one company owned 98 per cent of the shares of another).

But see *Apthorpe v. Peter Schoenhofen Brewing Co.*, 80 L. T. 395 (where one company acquired the personal property and all except three of the shares of another company); *St. Louis Breweries v. Apthorpe*, 79 L. T. 551.

² *Liebhardt v. Wilson* (Colo.), 88 Pac. 173; *Aberthaw Const. Co. v. Ransome*, 192 Mass. 434; 78 N. E. 485; *Chase v. Mich. Tel. Co.*, 121 Mich. 631; 80 N. W. 717 (corporation owning all shares except eight in an existing company and subsequently purchasing entire property and business not liable for torts

of the subordinate company). Cf. *Whiting Safety Catch Co. v. Western Wheeled, etc. Co.*, 148 Fed. 396 (holding owner of all except nominal amount of the capital stock a proper party defendant to a bill to restrain infringement of a patent by the corporation).

³ See *infra*, § 1291. Compare *Grand Valley Irr. Co. v. Fruita Imp. Co.* (Colo.), 86 Pac. 324, holding that in an action by one corporation for damages for an illegal forfeiture of shares owned by it in another corporation, evidence is admissible, in reduction of damages, that the person who bought in the forfeited shares was the owner of substantially all the stock of the plaintiff company.

tent of the authority reposed in him as an officer or agent of the corporation.¹ For example, although ordinarily an officer or agent of a corporation is not deemed to have the right to issue negotiable notes on behalf of the company without express authority, yet if the officer or agent in question be the owner of almost all the shares, the authority may perhaps be implied.² Any implied authority of this sort must, however, be confined to the business of the corporation, and cannot justify the dominant shareholder in spending the company's money on his own behalf — for instance, in paying a commission on a sale of his own shares.³ It has been held that although, in general, knowledge acquired by an agent when acting on his own account should not be imputed to his principal, yet this rule should not be strictly applied where the principal is a corporation in which the agent owns almost all the shares and which he manages as its virtual master and owner.⁴

§ 1083. **Inference that predominant Shareholder really owns Shares nominally held by Others.** — The fact that one person owns the entire capital of the company with the exception of a few shares sufficient to preserve a regular corporate organization and to qualify directors, may well be taken to indicate that the predominant shareholder really owns the shares which are nominally left outstanding in other hands. If the outstanding shares are transferred at his dictation and used to qualify any persons whom he may select as directors, this inference is strengthened. And if the fact be established that the predominant shareholder does in substance own the few shares which stand in the names of other persons, the principles of law apply which govern where one man owns literally all the shares.

¹ Cf. *Albro, etc. Co. v. Chinn* (Colo.), 77 Pac. 1097; *Jones v. England v. Dearborn*, 141 Mass. 590; *Williams*, 37 L. R. A. 682; 139 Mo. 1; 39 S. W. 486; 40 S. W. 353; 61 Am. St. Rep. 436; *Ellis v. Howe Machine Co.*, 9 Daly (N. Y.) 78 (headnote inadequate); *McElroy v. Minnesota Percheron Horse Co.*, 96 Wisc. 317; 71 N. W. 652.

to confess judgment for company); 6 N. E. 837 (president and owner of all the stock except two shares no power to mortgage property of corporation).

² *Baines v. Coos Bay, etc. Co.*, 77 Pac. 400; 45 Oreg. 307.

³ *Demarest v. Spiral Riveted Tube Co.*, 58 Atl. 161; 71 N. J. Law 14.

⁴ *Lea v. Iron Belt Merchantile Co.* (Ala.), 42 So. 415.

But see *Stokes v. N. J. Pottery Co.*, 46 N. J. Law 237, 242–243 (president and owner of all but two shares of the company's capital no power

§ 1084-§ 1089. *Incorporation for the Purpose of forming a One-Man Company*

§ 1084. **Validity of such Incorporation.** — The first question with respect to incorporation for the very purpose of enabling one individual to carry on business as the substantial owner of the company but with limited liability and with the other advantages of incorporation, is whether a company so formed can be deemed to be duly incorporated.

The incorporation laws provide that corporations may be organized by any number of individuals greater than a certain number — five, seven, and so on, as the case may be. If one person should undertake to incorporate by signing an incorporation paper with his own name alone, the courts would have no hesitation in holding the attempted incorporation void. So, also, if only one of the signatures represented a real person, the others being fictitious names, no corporation would be formed.¹

But suppose one incorporator associates with himself a number of “dummies” or persons having a merely nominal interest in the company, sufficient to make up the minimum required by the act. For example, suppose the capital of the projected corporation is to be divided into a thousand shares; and suppose one man subscribes the incorporation paper for nine hundred and ninety-four shares, while six of his clerks or servants subscribe for one share each. Is the company validly incorporated under a statute requiring the incorporation paper to be signed by seven individuals? One or two decisions may seem to indicate that this question should be answered in the negative.² But the preponderance of authority on both sides

¹ “I can conceive that there might be a limited company formed and registered by a person who had the sole interest in it, the other subscribing members being persons who were his *aliases*, and having no real existence; and in that case also (which does not occur here) there would be no legal company, and the real owner of the concern would be liable for its debts to the full extent

of his means.” Per Lord Halsbury, in *Salomon v. Salomon & Co.* (1897), A. C. 22.

² *Montgomery v. Forbes*, 148 Mass. 249; 19 N. E. 342; *Louisville Banking Co. v. Eisenman*, 94 Ky. 83, 88-89; 21 S. W. 531, 1049; 42 Am. St. Rep. 335; 19 L. R. A. 684; *Tillyer v. Hero Jar Co.*, 17 Phila. (Pa.) 153 (holding void an agreement by one corporator to hold his

of the Atlantic is that a literal compliance with the incorporation law is sufficient, and that the courts cannot read into the act a provision that each corporator must own a substantial interest.¹ The courts are not, however, altogether agreed as to whether this principle shall be carried out to its logical extent; but two divergent lines of decisions are traceable.

§ 1085. **Comparison with Companies not originally formed as One-Man Companies.** — In dealing with cases of incorporation for the very purpose of organizing a one-man company, reference may always be had to the cases where one person has acquired all or nearly all the shares in a company which was not incorporated for any such purpose. Any courts which in the last mentioned class of cases will brush aside the corporate fiction and regard the dominant shareholder as the owner of the business would *a fortiori* do so where the company was formed for the very purpose of enabling one man to carry on the business under cover of the corporate fiction. Indeed, the circumstance that the company was formed for the very purpose of being a one-man company would seem in theory to have no bearing except upon the question whether the original incorporation was valid. In practice, however, the courts are more likely to brush aside the corporate fiction in cases where the company was originally formed as a one-man company than in cases where one man has, by chance as it were, ac-

interest in the company as trustee or "dummy" for the dominant shareholder).

¹ *Salomon v. Salomon & Co.* (1897), A. C. 22; *Pott v. Schmucker*, 84 Md. 535; 36 Atl. 592; 57 Am. St. Rep. 415; 35 L. R. A. 392; *Rielle v. Reid*, 26 Ont. App. 54.

Cf. *Irvine Co. v. Bond*, 74 Fed. 849; *State ex rel. Tozer v. Probate Court* (Minn.), 113 N. W. 888 (holding that a transfer of all a man's property to a corporation organized by him in exchange for all except four of the shares is an irrevocable transfer of title).

"I do not see my way to holding that if there are seven registered members, the association is not a company formed in compliance with

the provisions of the Act, and capable of carrying on business with limited liability either because the bulk of the shares are held by some only, or even one of the members, and the others are what is called "dummies," holding, it may be, only one share of £1 each; or because there are less than seven persons who are beneficially entitled to the shares." Per Lord Davey in *Salomon v. Salomon & Co.* (1897), A. C. 54-55.

So, it is not against public policy to form a domestic corporation as an auxiliary or branch of a foreign corporation which is to own or control all the shares. *Day v. Postal Tel. Co.*, 66 Md. 354; 7 Atl. 608. Cf. *supra*, § 130.

quired from a number of different persons substantially all the shares in a corporation aggregate.

§ 1086. **Authorities carrying out logically Doctrine that Incorporation as One-Man Company is valid.** — The leading case in favor of carrying out logically the principle that a corporation formed as a one-man company is legally incorporated without regard to the quantum of interest held by the several members is *Salomon v. Salomon & Co.*¹ There, a certain Aron Salomon, a merchant, formed a corporation for the purpose of taking over and conducting his business. The capital was divided into 40,000 shares. Salomon, his wife, his daughter, and his four sons subscribed the memorandum of association for one share each. In payment for the transference of the business to the company, Salomon received 20,000 shares and first mortgage debentures to the amount of £10,000. No other shares were ever allotted. The company getting into difficulties and finally becoming insolvent, the House of Lords held that, the incorporation being valid, Salomon was protected from individual liability for the company's debts, and further was entitled, as debenture-holder, to a preference over the other creditors in the distribution of the company's assets. The House rejected the view that Salomon could be regarded for some purposes as though he were conducting the business under the *alias* of the corporation, so that its creditors would be his creditors and so that he could not be permitted to prove against the assets in competition with his own creditors.

So, where a land-owner conveyed his real estate to a corporation which he had formed under the laws of a foreign state, he himself owning all the capital, although in order to preserve the organization certain of his agents took nominally one share each, and where the objects of the incorporation were to secure limited liability for the expense of developing the property and also to give the federal courts jurisdiction, on the ground of diversity of citizenship, of a contemplated suit to test the validity of the title to the land, it was held that the incorporation was so far real and not colorable that the federal court should entertain jurisdiction of the said contemplated

¹ *Salomon v. Salomon & Co.* general doctrines, *Bartholomay Brewing Co. v. Wyatt* (1893), 2 Q. B. 499, (1897), A. C. 22.

See also in support of the same 516.

suit.¹ Similarly, where a land-owner conveyed his property to a corporation which was organized by himself and in which he held all the shares except two, the company was held to be the owner of the property in equity as well as at law, so that in a suit to foreclose a lien on the property, the heirs or personal representatives of the chief shareholder were not necessary parties.² Moreover, where K organized a corporation for the purpose of enabling him to sell certain land, which was transferred to the company in payment for all the shares except two, the court held that a mortgage of the property by the corporation, to secure a debt owing to K as the purchase price of certain of the shares held by him, was void.³

§ 1087. **Authorities which do not carry out the Doctrine logically.** — A Maryland case may be taken as representative of the diametrically opposite view. There one Nicholson formed a corporation in which he owned all the stock except four shares allotted respectively to four of his employees with the understanding that they should hold them only so long as they remained in his employ. Nicholson having become insolvent, the corporation was wound up. A firm of which Nicholson was a member had a claim against the company. The court held that while the company was validly incorporated so that the assets of the corporation could not be deemed to belong to Nicholson individually and so did not devolve upon his trustee in insolvency, still Nicholson was to be regarded as so far identical with the corporation that the firm of which he was a member should not be allowed to prove against its assets in competition with the other and outside creditors.⁴ It will readily be seen that this case stands at the opposite pole from *Salomon v. Salomon & Co.*; for the court regarded the incorporation as valid for one purpose but not for another purpose. Other American authorities incline to support the same doctrine as the Maryland case.⁵

¹ *Irvine Co. v. Bond*, 74 Fed. 36 Atl. 592; 57 Am. St. Rep. 415; 849.

² *Fox v. Robbins* (Tex.), 70 S. W. 597. (The decision is capable of being supported on another ground.)

³ *Haines Mercantile Co. v. Highland Gold Mines Co.* (Oreg.), 88 Pac. Co., 90 Fed. 348; 33 C. C. A. 95; 865. *Re Bauernschmidt's Estate*, 97 Md.

⁴ *Pott v. Schmucker*, 84 Md. 535; 35; 54 Atl. 637; *Bauernschmidt*

§ 1088. **Rights of Subsequent Shareholders and Creditors of the Company.**—All courts agree that a one-man company is to be treated as validly incorporated so far as may be necessary for the protection of innocent shareholders and creditors of the corporation. For example, where the company was formed for the purpose of taking a transfer of property belonging to an insolvent debtor and of charging it with the claim of a favored creditor, the Maryland Court of Appeals, which as stated in the last paragraph is very liberal in disregarding the corporate entity in the case of one-man companies, nevertheless held that the transaction whereby the company assumed the debt due the favored creditor should be set aside as a fraud upon subsequent creditors of the corporation.¹ The court said, "The corporation is to be considered as a person *sui juris* having an independent existence, distinct from the individual stockholders. It becomes subject to legal responsibilities just as a natural person endued with judgment and volition. The stockholders are beneficially the owners of its property, and they may control its action; but it is beyond their power to exempt it from any legal responsibility which it may incur. If a natural person should enter into a combination such as we have described, the law would adjudge that the parties had associated together with intent to delay, hinder, and defraud subsequent creditors. And such must be the judgment here."²

§ 1089. **Organization of One-Man Corporation as Cover for Fraud.**—Whenever a one-man company is incorporated in order that the corporate fiction may be set up as a cover for fraud, the courts will frustrate the attempt regardless of the theoretical nature of the corporate entity.³ *In fictione juris semper substitit equitas*. Indeed, this principle is not peculiar to one-man companies. For example, where persons who have obtained property by fraud organize a corporation in which they themselves take more than ninety-nine one hundredths of the total number of shares, the remainder being held by their mere "dummies," the corporation upon purchasing the property

v. *Bauernschmidt*, 101 Md. 148; 60 Atl. 437.

² 85 Md. 69-70. Cf. *supra*, § 1079.

¹ *Folsom v. Detrick Fertilizer Co.*, 85 Md. 52; 36 Atl. 446.

³ Cf. *supra*, § 1078.

which had been fraudulently acquired cannot pose as a purchaser for value without notice so as to cut off the defrauded party's right of rescission.¹ So, to take another illustration, where a person uses a corporation controlled by himself for the transaction of his own business for the purpose of cheating his own creditors, he may be held individually liable although the obligation is in form that of the company.² Such cases are, however, mere applications of the general principle that equity will disregard the corporate fiction for the purpose of preventing the successful perpetration of the fraud. The court looks behind the corporate entity, not because one man owns substantially all the shares, but because of the fraud. It would do the same thing if the corporation were composed of a thousand members. The only difference is that the fraud could not be so easily perpetrated where the members of the corporation are numerous.

A fortiori, where an insolvent debtor organizes a corporation and transfers to it a large part of his property in payment of the shares subscribed for by him, the transaction may be set aside as a conveyance in fraud of his creditors, and accordingly the property so transferred may be levied upon as the property of debtor.³ The corporate fiction has been thought to constitute a barrier or obstacle to such a proceeding; but there is difficulty in finding any basis for such an opinion. Indeed, the result would be the same if the corporation to whom the property was transferred was composed mainly of other persons — in other words, if the corporation were not a one-man company — provided only the company could be affected with notice of the circumstances which rendered the transfer fraudulent as against the transferor's creditors, and provided the fraudulent intent could be proved. The fact that the vendor owns substantially all of the shares is a circumstance to be considered in determining whether the transfer is actually fraudulent. Obvi-

¹ *Hoffman Coal Co. v. Cumberland Coal, etc. Co.*, 16 Md. 456; 77 Am. Dec. 311. See *supra*, § 348.

² *Donovan v. Purtell*, 216 Ill. 629; 75 N. E. 334.

³ *First Nat. Bank v. Trebein Co.*, 59 Oh. St. 316; 52 N. E. 834. Cf.

Watson v. Bonfils, 116 Fed. 157; 53 C. C. A. 535; *Re Hirth* (1899), 1 Q. B. 612 (where the transfer was held an act of bankruptcy, and therefore void by relation *ab initio*).

See also *supra*, § 346.

ously, a creditor who undertakes to levy on the shares issued to his debtor by a corporation which he organized to take over his business, thereby affirms the conveyance to the company and cannot at the same time have the conveyance set aside as fraudulent.¹

¹ *Rielle v. Reid*, 26 Ont. App. 54, 61-62.

CHAPTER XVIII

PUBLICITY IN CORPORATE AFFAIRS — INSPECTION OF BOOKS AND RECORDS

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§ 1090. **Subject and Scheme of Treatment.** — The various books and records of corporations often contain information of great importance both to members of the company, to rivals

in business, and, in the case of public-service and financial companies, to the public at large. The degree of publicity which the various parties interested may legally insist upon in respect to such documents has, therefore, been the bone of contention in many litigated cases, and will form the subject of the present chapter.

In the first place we shall consider the degree of publicity in corporate affairs which is required at common law, and secondly, the statutory provisions upon the subject. Lastly, we shall consider how the right to inspect corporate records, whether that right exist at common law or be conferred by statute, may be exercised, and how the right if denied or obstructed may be vindicated and enforced.

§ 1091-§ 1103. INSPECTION OF BOOKS AND RECORDS OF CORPORATIONS AT COMMON LAW

§ 1091. **Discovery according to Rules and Principles of Equity.**

— At the outset we may put aside all cases in which production of corporate books and records may be compelled by way of discovery according to the established rules and procedure of chancery or, according to the modern relaxed or statutory practice, on motion in a pending action at law. These cases involve no principles peculiar to the law of corporations.¹ Production of documents in the possession of a corporation may be compelled by way of discovery under precisely the same circumstances, and no others, that the production might have been had if the papers had been in the possession of an individual.² For

¹ Cf. *Rex v. Babb*, 3 T. R. 579 (headnote inadequate).

But see *Wolfe v. Underwood*, 96 Ala. 329 (where the court refused to entertain a bill for discovery and production of documents against a corporation, on the ground that the remedy at law by mandamus to compel an inspection of books was adequate).

² *Mayor, etc. of Southampton v. Graves*, 8 T. R. 590 (headnote inadequate).

For cases on inspection of cor-

porate books by way of discovery, see *Williams v. Prince of Wales, etc. Co.*, 23 Beav. 338; *Hill v. Great Western Ry. Co.*, 10 C. B., N. S., 148; *Metropolitan, etc. Co. v. Hawkins*, 4 H. & N. 146; *Pepper v. Chambers*, 7 Ex. 226; *Corporation of Barnstable v. Lathey*, 3 T. R. 303; *Mayor of Lynn v. Denton*, 1 T. R. 689; *West Devon Great Consols Mine*, 27 Ch. D. 106; *Whitworth v. Erie R. R. Co.*, 5 Jones & S. (N. Y.) 437; *Ervin v. Oregon, etc. R. R. Co.*, 22 Hun (N. Y.) 566; *Morgan v. Morgan*, 16 Abb. Pr.,

an explanation of the circumstances under which production of documents may be enforced by way of discovery, reference is therefore made to the recognized works on the subject of equity pleading and practice, and of discovery and the production of documents.¹

§ 1092. **Production of Books and Documents as Evidence under Subpœna Duces Tecum or similar Writ.** — We should also distinguish all cases in which the production of corporate books as evidence may be required under a *subpœna duces tecum*.² Such production is not required for the purpose of *inspection* or inves-

N. S. (N. Y.), 291; *New England Iron Co. v. New York Loan, etc. Co.*, 55 How. Pr. (N. Y.) 351; *Thompson v. Erie Ry. Co.*, 9 Abb. Pr., N. S., 212; *Draper v. Manchester, etc. Ry. Co.*, 3 De G. F. & J. 23; *Imperial Gas Co. v. Clarke*, 7 Bing. 95; *Hoyt v. Am. Exchange Bank*, 1 Duer (N. Y.) 652; *Walker v. Granite Bank*, 44 Barb. (N. Y.) 39; *Opdyke v. Marble*, 44 Barb. (N. Y.) 64; *Ranger v. Champion Cotton-Press Co.*, 51 Fed. 61; *Martin v. New Trinidad Lake Asphalt Co.*, 87 New York App. Div. 472; 84 N. Y. Supp. 711; *Hart v. American Cotton Co.*, 41 N. Y. Misc. 436; 84 N. Y. Supp. 1065; *Manning v. Berdan*, 135 Fed. 159, 163 (head-note inadequate); *Maeder v. Buf-jalo Bill's Wild West Co.*, 132 Fed. 280; *Ridgely v. Richard*, 130 Fed. 387; *Clark v. Rhode Island Locomotive Works*, 53 Atl. 47; 24 R. I. 307 (where a creditor obtained discovery of the names of shareholders who were subject to a statutory liability to him); *Fuller v. Alexander Hol-lander & Co.* (N. J.), 47 Atl. 646; 61 N. J. Eq. 648; 88 Am. St. Rep. 456; *Victor G. Bloede Co. v. Joseph Ban-croft & Sons Co.*, 98 Fed. 175; *Weir v. Bay State Gas Co.*, 91 Fed. 940; *Clarke v. Eastern Bldg., etc. Ass'n*, 89 Fed. 779 (where the right of a shareholder by way of discovery was confused with the right as relief); *Brooklyn Union Gas Co. v. City of New York*, 115 N. Y. 69 (where an inspection in aid of immaterial aver-

ments was refused); *Wood v. Mott Iron Works*, 114 N. Y. App. Div. 108 (inspection refused); *Arbuckle v. Woolson Spice Co.*, 21 Oh. Circ. Ct. 347 (inspection allowed by way of discovery under a statute); *Arbuckle v. Woolson Spice Co.*, 21 Oh. Circ. Ct. 356 (same statute); *Harbaugh v. Middlesex Securities Co.*, 110 N. Y. App. Div. 633; 97 N. Y. Supp. 350; *Snyder v. De Forest Wireless Tel. Co.*, 113 N. Y. App. Div. 840; 99 N. Y. Supp. 644 (inspection denied shareholder when claimed as a litigant and not as a shareholder); *Jacobs v. Mexican Sugar, etc. Co.*, 112 N. Y. App. Div. 655; 98 N. Y. Supp. 541; *People v. Am. Ice Co.*, 104 N. Y. Supp. 858; *Cassatt v. Mitchell Coal, etc. Co.*, 150 Fed. 32 (an important case construing the Federal Judiciary Act).

¹ 3 Chitty's Gen. Practice, 433 et seq.; Story's Eq. Pl., § 858-§ 860; Wigram on Discovery, 13 et seq., 199 et seq.

² See *Crocker-Wheeler Co. v. Bul-lock*, 134 Fed. 241; *Mauthey v. Wyoming, etc. Ins. Co.*, 76 N. Y. App. Div. 579; 78 N. Y. Supp. 596; *Clarke v. Eastern Bldg., etc. Ass'n*, 89 Fed. 779; *Nelson v. U. S.*, 201 U. S. 92; 26 Sup. Ct. 358; *Santa Fé Pac. R. R. Co. v. Davidson*, 149 Fed. 603; *Emma Silver Mining Co.*, 10 Ch. 194 (where the distinction between production by way of discovery and under a *subpœna duces tecum* was luminously discussed.)

tigation as to the contents of the books,¹ but is allowed only when the books contain relevant matter, — a circumstance which the court must find before the books are opened for the inspection of the adverse party. For the law respecting the circumstances under which a corporation or its officers may be compelled to produce its books in evidence before a court or jury, reference is made to the treatises on evidence.² The writ of *subpœna duces tecum*, at common law, must run against the officer or custodian of the papers and not against the corporation itself;³ and this fact is sufficient justification for a statute applicable to corporations and not to natural persons, and providing for issue of a subpœna against the corporate entity.⁴

§ 1093. **Books of Corporations not open as Public Records.** — But what is commonly designated as the right to inspect corporate books and records is wholly different from the right to discovery,⁵ and still more distinct from the right to require production of books as evidence. The notion has sometimes prevailed even among lawyers that a corporation is necessarily a quasi-public body, and that its papers, records, and proceedings ought, therefore, to be open to public inspection. But clearly no such indiscriminate publicity is required. If it were, no industrial or commercial business could ever be carried on by a corporation. The books of business corporations or even of public-service corporations are not public records.⁶ If in any

¹ *Southern Ry. Co. v. North Carolina Corp. Comm.*, 104 Fed. 700.

As to whether a subpœna to produce all the documents of a corporation before a grand jury is a violation of the constitutional guaranty against unreasonable searches and seizures, see *Hale v. Henkel*, 201 U. S. 43; 26 Sup. Ct. 370. Cf. *Consolidated Rendering Co. (Vt.)*, 66 Atl. 790, affirmed as to federal questions, *sub nom. Consolidated Rendering Co. v. Vermont*, 28 Sup. Ct. 178.

² See 3 Wigmore on Evidence, § 2209. That a corporation may, under a subpœna against its officers, be required to produce books and papers which an individual might refuse to produce, see *Hale v. Henkel*, 201 U. S. 43; 26 Sup. Ct. 370;

International Coal Mining Co. v. Pennsylvania R. Co., 152 Fed. 557.

³ But cf. *Emma Silver Mining Co.*, 10 Ch. 194.

⁴ *Consolidated Rendering Co. v. Vermont*, 28 Sup. Ct. 178, affirming *Consolidated Rendering Co. (Vt.)*, 66 Atl. 790.

⁵ See *Fuller v. Alexander Hollander & Co. (N. J.)*, 47 Atl. 646; 61 N. J. Eq. 648; 88 Am. St. Rep. 456; *Rex v. Babb*, 3 T. R. 579 (where the distinction was clearly pointed out by Lord Kenyon); *Hub Const. Co. v. New England Breeders' Club (N. H.)*, 67 Atl. 574; Wigmore on Evidence, § 1858 (2).

⁶ *Lipscomb v. Condon*, 56 W. Va. 415; 49 S. E. 392; 107 Am. St. Rep. 938; 67 L. R. A. 670; *Louisville*,

case an inspection of a corporation's books and papers is to be enforced, undoubtedly it behooves the applicant to show some special title to the privilege of examination: he cannot claim it merely as a citizen.

§ 1094-§ 1100. *Rights of Shareholders.*

§ 1094. **Distinction between Rights of Shareholders and Rights of Partners.**—In the case of shareholders, the right is often claimed by virtue of their proprietorship in the corporation. A partner, of course, has at common law an unquestioned right of access at all times to any and all books and papers belonging to the firm, and it is often sought to vindicate for shareholders an analogous right. But the cases are totally dissimilar. The partner's right rests upon his ownership of the firm property, and, like other property rights, is absolute, and may be exercised without regard to motive or purpose. Shareholders in a corporation, on the other hand, are not co-owners of its property or papers, and cannot therefore assert claims based upon ownership of the company's property. Moreover, if all the numerous shareholders in a large corporation enjoyed the same unlimited right of access to its books and papers that partners enjoy in respect to the firm's effects, the affairs of the corporation would practically be open to public view, and the successful operation of its business, at least in competition with individuals, would be seriously jeopardized. The shareholder's right, if any he have, must be much more restricted than that of a partner. Accordingly, a shareholder has no absolute right to inspect any and all of the company's documents merely upon an allegation that he believes the affairs of the corporation are being mismanaged.¹

§ 1095. **Shareholders more favored than the Public at large.**—On the other hand, the shareholders do constitute the corpora-

etc. Ry. Co. v. Louisville Trust Co., 174 U. S. 552, 575-576; 19 Sup. Ct. 817. corporations should be "kept as public records").

Cf. *State ex rel. Bourdette v. Gaslight Co.*, 49 La. Ann. 1556; 22 So. B. & Ad. 115. But see *Guthrie v. Harkness*, 199 U. S. 148; 26 Sup. Ct. 4.

tion, and control its destinies. If this control is to be intelligently exercised, they must have some means of learning for themselves the true condition of its affairs, and of subjecting the management of the directors and officers to a really searching scrutiny. Accordingly, it is submitted that, although shareholders have no absolute right to inspect all the company's papers, yet they should be accorded the privilege, under *some* circumstances, of examining *some* of them for *some* purposes.

§ 1096. **Right to inspect By-laws, Minutes of General Meetings, Share Register.** — For instance, the shareholders certainly have a right to know by what regulations the company is governed, and to that end should have the right to examine the company's record, if any be kept, of its by-laws and ordinances.¹ So, too, for somewhat the same reasons, the shareholders are manifestly entitled to know what has taken place at general meetings of the company, and to that end should be allowed at all reasonable times to examine the minutes of such meetings.² Moreover, every shareholder has the right to canvass the company, and to conduct a campaign among the members in favor of those policies which he wishes the company to pursue; and to that end, as well as for the purpose of ascertaining whether his title to his stock is properly registered, he should have access to the company's stock book or register of shareholders.³ These rights of the shareholder, however, to make an inspection of these records of the company are given for particular objects, and should therefore be exercisable only when the applicant's purpose is a *bona fide* pursuit of those objects, and not where he has some other end in view — for example, to give to the cred-

¹ Cf. *Re Coats*, 75 N. Y. App. Div. 567; 78 N. Y. Supp. 429.

² *Burton, etc. Co.*, 31 L. J. Q. B. 62; *Alabama, etc. R. R. Co. v. Rowley*, 9 Fla. 508, 514 (semble).

³ *People ex rel. Stobo v. Eadie*, 63 Hun 320; 18 N. Y. Supp. 53 (affirmed on opinion below in 133 N. Y. 573; 30 N. E. 1147); *People ex rel. Hatch v. Lake Shore, etc. R. R. Co.*, 11 Hun (N. Y.) 1.

Cf. *Foster v. Bank of England*, 8 Q. B. 689.

But see *Lyon v. Am. Screw Co.*,

16 R. I. 472; 17 Atl. 61 (holding that a shareholder is entitled to inspect the company's register of members only when the circumstances are such as to entitle him to examine the account books, etc.); *People ex rel. Venner v. New York Life Ins. Co.*, 111 N. Y. App. Div. 183; 97 N. Y. Supp. 465 (holding that policyholder in a mutual insurance company, unlike a shareholder in a joint-stock company, has no right to inspect index of members).

itors of the company the names of its shareholders to enable the former to enforce the statutory liability of the latter.

§ 1097. **Right to inspect Account Books, Ledgers, etc.**—When the shareholder seeks access to the ordinary account books, ledgers, etc., of the company, he should make out a stronger case.¹ Indeed, on principle, one might well doubt whether any right to inspect such books exists apart from statute. For, to concede to every shareholder an unrestricted right of examining books of that sort would spell ruin for most corporations, and to confine the privilege within proper limits can better be done by the legislature than the judiciary. However, according to the weight of authority, some right of the sort exists at common law,² but arises only when the shareholder can show a definite, substantial reason for the inspection, such as a *prima facie* case, or at least a *bona fide* suspicion, of fraud or mismanagement on the part of those in control of the company,³ and can be exercised only when the applicant's motive

¹ As to this distinction, see *Re State ex rel. English v. Lazarus* (Mo.), Coats, 75 N. Y. App. Div. 567; 78 105 S. W. 780.
N. Y. Supp. 429.

But see *Rex v. Bank of England*,

² *Guthrie v. Harkness*, 199 U. S. 2 B. & Ald. 620.
148; 26 Sup. Ct. 4; *Ranger v. Rex v. Merchant Tailors' Co.*,
Champion Cotton-Press Co., 51 Fed. 2 B. & Ad. 115; *Commonwealth v.*
61; *Swift v. State ex rel. Richardson*, *Phœnix Iron Co.*, 105 Pa. St. 111;
7 Houst. (Del.) 338; 6 Atl. 856; 32 51 Am. Rep. 184; *Phœnix Iron Co.*
Atl. 143; 40 Am. St. Rep. 127; *Ells- v. Commonwealth*, 113 Pa. St. 563;
worth v. Dorwart, 95 Iowa 108; 63 6 Atl. 75; *Latimer v. Herzog Tele-*
N. W. 588; 58 Am. St. Rep. 427; *seme Co.*, 75 N. Y. App. Div. 522;
Stone v. Kellogg, 165 Ill. 192; 46 N. E. 78 N. Y. Supp. 314; *Colwell v. Col-*
222; 56 Am. St. Rep. 240; *Huyilar well Lead Co.*, 76 N. Y. App. Div.
v. Cragin Cattle Co., 40 N. J. Eq. 392, 615; 78 N. Y. Supp. 607. Cf. *Ells-*
398-399; 2 Atl. 274; *Re Steinway*, *worth v. Dorwart*, 95 Iowa 108; 63
159 N. Y. 250; 53 N. E. 1103; 45 N. W. 588; 58 Am. St. Rep. 427;
L. R. A. 461; *Rosenfeld v. Einstein*, *Hatch v. City Bank*, 1 Rob. (La.) 470
46 N. J. Law 479, 483 (semble); (headnote misleading); *People ex rel.*
Commonwealth v. Phœnix Iron Co., *Hatch v. Lake Shore, etc. R. R. Co.*,
105 Pa. St. 111; 51 Am. Rep. 184; 11 Hun (N. Y.) 1; *Lyon v. Am.*
Lewis v. Brainerd, 53 Vt. 519, 521 *Screw Co.*, 16 R. I. 472; 17 Atl. 61;
(semble); *Cockburn v. Union Bank*, *People ex rel. Bishop v. Walker*, 9
13 La. Ann. 289; *State ex rel. Martin Mich. 328; Burton, etc. Co.*, 31
v. Bienville Oil Works Co., 28 La. L. J. Q. B. 62; *Cobb v. Lagarde*
Ann. 204; *Neubert v. Armstrong* (Ala.), 30 So. 326; 129 Ala. 488
Water Co., 211 Pa. St. 582; 61 Atl. (evidence of insolvency of company
123; *Varney v. Baker* (Mass.), 80 admitted as tending to show reason-
N. E. 525 (headnote misleading); able cause for examining the books);
State ex rel. Johnson v. St. Louis Re O'Neill, 95 N. Y. Supp. 964; 47
Transit Co. (Mo.), 100 S. W. 1126; N. Y. Miss. 495.

is the protection of his interests as a member of the corporation.¹ The right, therefore, extends to such papers only as are pertinent to the controversy which gives rise to the right.² Where a shareholder seeks the inspection not for the purpose of protecting his interests as a member of the corporation, but in order to procure evidence in support of an individual action of deceit against the directors, the right must be denied him.³ The right of the company, if any, to require the shareholder to disclose the object of his desired inspection is waived where the refusal to give him access to the books is placed upon another and untenable ground.⁴

§ 1098. **Right to inspect Minutes of Directors' Meetings.** — The minutes of the directors are in respect to the subject we are now considering more like books of accounts and so forth than books of minutes of shareholders' meetings. Hence, in the absence of some special reasons for needing an inspection, a shareholder has no right at common law to inspect the minutes of directors' meetings.⁵

§ 1099. **By-laws affecting Right of Shareholders.** — The by-laws or other regulations of a corporation may confer upon its members a greater right of inspecting the books and papers of the company than they would otherwise possess. Where such is the case, the extent of the shareholder's right will depend upon the construction of the by-laws or regulations in question; and

¹ *Re Steinway*, 159 N. Y. 250; 53 N. E. 1103; 45 L. R. A. 461 (semble); *Phoenix Iron Co. v. Commonwealth*, 113 Pa. St. 563, 572; 6 Atl. 75; *Investment Co. v. Eldridge*, 2 Pa. Dist. Rep. 394 (where the inspection was desired to procure evidence to sustain a plea of fraud to an action by the company on a promissory note of the shareholder); *Re Kennedy*, 75 N. Y. App. Div. 188; 77 N. Y. Supp. 714; *Re Coats*, 73 N. Y. App. Div. 178; 76 N. Y. Supp. 730; *State ex rel. Bruning v. Hoboken Printing, etc. Co.* (N. J.), 50 Atl. 906; 67 N. J. Law 119; *People ex rel. Callanan v. Keeseville, etc. R. R. Co.*, 106 N. Y. App. Div. 349; 94 N. Y. Supp. 555 (semble).

But see *State ex rel. Doyle v. Laughlin*, 53 Mo. App. 542. Cf.

State v. Pan-American Co. (Del.), 61 Atl. 398; *Garcin v. Trenton Rubber Mfg. Co.* (N. J.), 60 Atl. 1098; *State ex rel. English v. Lazarus* (Mo.), 105 S. W. 780 (where a shareholder in a rival company was allowed to inspect the books but with certain safeguards against disclosure of trade secrets).

² *Commonwealth v. Phoenix Iron Co.*, 105 Pa. St. 111; 51 Am. Rep. 184.

³ *Re Taylor*, 101 N. Y. Supp. 1039.

⁴ *State ex rel. Johnson v. St. Louis Transit Co.* (Mo.), 100 S. W. 1126.

⁵ *Regina v. Mariquita Mining Co.*, 1 E. & E. 289; *Alabama, etc. R. R. Co. v. Rowley*, 9 Fla. 508, 514 (semble). Cf. *Birmingham, etc. Ry. Co. v. White*, 1 Q. B. 282.

this construction is governed by the same considerations as the construction of statutes conferring similar rights. The rules relating to statutory construction are given below. While a by-law may enlarge the right of inspecting the books and provide for greater publicity than is prescribed by public law,¹ yet no by-law can restrict a statutory right of inspecting the books,² nor, it would seem, any right of inspection which is conferred by the common law.³

§ 1100. **Statutes tending to restrict Right of Shareholders.** — The common-law right of every shareholder to inspect corporate books is not abrogated or cut down by a statute providing that the company shall not be subject to any visitorial powers except such as may be authorized by statute;⁴ for the inspection of books by shareholders is not an exercise of visitorial powers. Moreover, the common-law rights of the several shareholders are not diminished by a statutory provision that "all the powers of the corporation shall be exercisable by a board of directors."⁵ As will be shown below, statutes which confer upon shareholders a limited right to inspect the company's books should not be construed to restrict by implication their common-law rights.⁶

§ 1101. **Rights of a Director.** — The position of a director in respect to the right of examining the company's books and papers is very different from that of a mere shareholder. He is, so to speak, a managing partner. His duty is to become thoroughly familiar with the company's affairs, and to that end he should be allowed and indeed encouraged to examine any or all of the company's books and papers of whatsoever nature. Accordingly, a single director has the right against the opposition of the majority of the board to inspect any of the company's books.⁷

¹ *Wyoming Coal Mining Co. v. State ex rel. Kennedy* (Wyo.), 87 Pac. 337. ⁵ *State ex rel. Martin v. Bienville Oil Works*, 28 La. Ann. 204.

² See *infra*, § 1110.

⁶ *Infra*, § 1109.

³ *State ex rel. Burke v. Citizens' Bank*, 51 La. Ann. 426; 25 So. 318. But see *Ranger v. Champion Cotton-Press Co.*, 51 Fed. 61 (semble).

⁷ *People ex rel. Muir v. Throop*, 12 Wend. (N. Y.) 183; *Stone v. Kellogg*, 62 Ill. App. 444 (affirmed on another ground in 165 Ill. 192; 46 N. E. 222; 56 Am. St. Rep. 240);

⁴ *Guthrie v. Harkness*, 199 U. S. 148; 26 Sup. Ct. 4. *People ex rel. McInnes v. Columbia Bag Co.*, 103 N. Y. App. Div. 208;

Doubtless, if the director sought to abuse this right by using the information so acquired for his personal advantage or for the injury of the company, the courts would find a remedy.¹ But the fact that the director who demands the right of inspection was chosen director as the representative of a rival concern and that his motive is not the promotion of the company's interests has been held to be no ground for refusing to permit him to see the books.²

It must be conceded that in some cases the courts have evinced a disposition, which can hardly be regarded as other than unintentional, to assimilate the position of a director to that of a mere shareholder, in respect to the right of examining the company's books.³

§ 1102. **Rights of Creditors and other Non-members.** — That creditors of a corporation, and *a fortiori* other non-members,⁴ have no power at common law to compel the company to permit them to examine its books or records of any sort whatsoever (except of course by way of discovery) would seem very clear. The lack of judicial authority for that proposition is probably due to the fact that no creditor has ever thought it worth while to make a test case.

§ 1103. **Right to inspect Books in Possession of Receiver.** — Where the corporation is in the hands of a receiver, whether or not a shareholder or any one else should be permitted to inspect the books and papers in the receiver's possession is clearly within the mere discretion of the court.⁵ The inspection will

92 N. Y. Supp. 1084; *People ex rel. Leach v. Central Fish Co.*, 101 N. Y. Supp. 1108; *Burn v. London & South Wales Coal Co.*, 7 Times L. R. 118 (holding that the right may be exercised at all times and not merely at board meetings).

² *People ex rel. Leach v. Central Fish Co.*, 101 N. Y. Supp. 1108.

³ *Hatch v. City Bank*, 1 Rob. (La.) 470 (headnote misleading); *People ex rel. Onderdonk v. Mott*, 1 How. Pr. (N. Y.) 247.

⁴ Cf. *Investment Co. v. Eldridge*, 2 Pa. Dist. Rep. 394. See also *supra*, § 1093.

⁵ For cases in which the court permitted the inspection, see, in addition to the cases cited below, *People v. Cataract Bank*, 5 N. Y. Misc. 14; 25 N. Y. Supp. 129; *Birmingham Banking Co.*, 36 L. J. Ch. 150 (decided under § 156 of the Companies Act of 1862, and holding that a secrecy clause in the articles of

But see *Rosenfeld v. Einstein*, 46 N. J. Law 479.

¹ Cf. *Heminway v. Heminway*, 58 Conn. 443; 19 Atl. 766 (where the company's secretary was held to be justified in committing an assault upon a director for the purpose of regaining possession of the company's papers, from which the director was making extracts for the benefit of a rival corporation).

not be refused because the object is to obtain material to convince the other shareholders that a plan of reorganization which has been approved by the majority should not be carried out.¹ On the other hand, it will ordinarily be refused to one who purchased his shares after the commencement of the receivership.² A shareholder who is permitted by the court to examine the books of the company which is being wound-up by the court may be enjoined from divulging the information which he acquires.³

§ 1104-§ 1110. *Statutory Rights of Inspection.*

§ 1104. **In general — Rules of Construction.** — Statutes very generally confer upon the shareholders, and sometimes upon creditors, some right to inspect the corporate books.⁴ A constitutional provision that the books of corporations shall be open to inspection has been held to be self-executing so that the right so conferred is enforceable without the aid of subsequent legislation.⁵ The extent of such constitutional or statutory rights depends of course entirely on the terms of the particular enactment in question. As we have stated above, the rules of construction are the same whether the right be given by statute or by regulations of the company. As a general rule, the more sweeping the terms of the statute, the readier the courts will be to read into it conditions and limitations; and where the terms in which the right is conferred are circumscribed, the courts, influenced by the argument *ab inconvenienti*, will refuse to extend the right by construction. A statute which imposes a penalty

association should not prevent the inspection but that the shareholders should be enjoined from divulging secrets); *Lancashire Cottonspinning Co. v. Greator*, 14 L. T. 290 (decided under a statute). Cf. *Morgan's Case*, 28 Ch. D. 620 (where under the same statute the court refused to order the inspection prayed for).

¹ *Chable v. Nicaragua Canal, etc. Co.*, 59 Fed. 846.

² *Chable v. Nicaragua Canal, etc. Co.*, 59 Fed. 846.

³ *Joint Stock Discount Co.*, 36 L. J. Ch. 150.

⁴ A New Jersey statute authorizes a summary order, "upon proper cause shown," requiring corporations to bring their books within the state. For cases arising under this statute, see *Mitchell v. Rubber Reclaiming Co.*, 24 Atl. Rep. 407 (N. J.); *Fulmer v. Hollander, etc. Co.*, 61 N. J. Eq. 648; 88 Am. St. Rep. 456; *Hodgens v. United Copper Co.* (N. J.), 67 Atl. 756; *Huyler v. Cragin Cattle Co.*, 40 N. J. Eq. 392; 2 Atl. 274; 42 N. J. Eq. 139; 7 Atl. 521.

⁵ *State ex rel. Bourdette v. Gaslight Co.*, 49 La. Ann. 1556 (headnote inadequate); 22 So. 815.

for denial of the right must be construed strictly,¹ yet not so strictly as to defeat the obvious intention of the legislature.²

§ 1105. **To what Corporations Statute applies.** — A provision in a state statute that shareholders in all private corporations shall have the right of examining the books and papers of the company has been held, though not without dissent, to apply to national banks.³ It has also been held that a domestic statute applies to books of a foreign corporation which are within the state.⁴ Some statutes expressly apply to books of foreign corporations.⁵

§ 1106. **To what Books and Papers Statutory Right extends.** — A provision that "the books wherein the proceedings of the company are recorded" shall be open to the inspection of the shareholders applies only to minutes of shareholders' meetings and not to minutes of directors' meetings.⁶ On the other hand, a statute providing that "the president and directors of every corporation shall keep full, fair, and correct accounts of their transactions which shall be open at all times to the inspection of the stockholders" has been held, by the adoption of a very liberal construction, to entitle the stockholders to inspect not merely the minutes of directors' meetings but all account books etc.⁷ A statute requiring every corporation to keep a record of its financial condition, which shall be open to inspection by any shareholder, does not give a shareholder the right to inspect the original vouchers and papers from which that record is made up.⁸ So, a statute which au-

¹ Cf. *Hub Const. Co. v. New England Breeders' Club* (N. H.), 67 Atl. 574 (holding that a statute imposing a penalty on the clerk who refuses to furnish a certified copy of a document to a person entitled to inspect the same does not apply where the corporation refuses to allow the applicant to inspect the document).

But see *Clawson v. Clayton* (Utah), 93 Pac. 729.

² *Cothel v. Brouwer*, 5 N. Y. 562.

³ *Winter v. Baldwin*, 89 Ala. 483; 7 So. 734; *People ex rel. Lorge v. Consolidated Nat. Bank*, 105 N. Y. App. Div. 409; 94 N. Y. Supp. 173.

As to the power of Congress over state corporations, compare *Inter-*

state Commerce Commission v. Hariman, 157 Fed. 432.

⁴ *Nettles v. McConnell* (Ala.), 43 So. 838.

⁵ See *People ex rel. Althause v. Giroux Consol. Mines Co.*, 107 N. Y. Supp. 188; *Althause v. Giroux*, 107 N. Y. Supp. 191.

⁶ *Regina v. Maraquita, etc. Mining Co.*, 1 E. & E. 289.

⁷ *Weihenmayer v. Bitner*, 88 Md. 325; 42 Atl. 245; 45 L. R. A. 446 (notice especially plaintiff's fourth prayer, which the court held ought to have been granted).

⁸ *Ellsworth v. Dorwart*, 95 Iowa 108 (headnote inadequate); 63 N. W. 588; 58 Am. St. Rep. 427. Cf.

thorizes a court of equity to order that the books of the company be brought into the state for inspection by the shareholders does not extend to the original papers and memoranda of the corporation.¹ A statutory right of examining the company's "accounts" is not confined to the "stock accounts" or stock books because the provision in question is found in a part of the statute headed "Capital Stock."² A statutory right of inspecting a register which is required to be kept by act of Parliament includes a right to examine all parts of the book, and not merely those parts which relate to the applicant.³ Moreover, where the company neglects to keep a book of the kind pointed out by the statute, the shareholders may insist on inspecting the only book which the company does keep containing the information to which they are entitled, although it also contains other matter that they would ordinarily have no right to see.⁴

§ 1107. **What Persons are within the Statute.** — The statutory right is usually confined to shareholders but is sometimes extended to creditors.⁵ When the right is confined to shareholders, the courts as a rule should hold that only registered shareholders can avail of it.⁶ Otherwise, the corporation would have no means of determining whether an applicant for inspection was entitled to exercise the right. Of course, if the register of shareholders is erroneous and the error is due to the company's own fault, then on familiar principles the person who ought to have been registered will be entitled to the same rights as if he were actually registered. An executor or administrator of a deceased shareholder who has exhibited his letters to the company would

Lyon v. Am. Screw Co., 16 R. I. 472; 17 Atl. 61.

¹ *Huyilar v. Cragin Cattle Co.*, 42 N. J. Eq. 139; 7 Atl. 521.

² *State ex rel. Bergenthal v. Bergenthal*, 72 Wisc. 314; 39 N. W. 566.

³ *Holland v. Dickson*, 37 Ch. D. 669. Cf. *Stone v. Kellogg*, 165 Ill. 192; 46 N. E. 222; 56 Am. St. Rep. 240.

⁴ *People ex rel. Richmond v. Pac. Mail S. S. Co.*, 50 Barb. 280.

⁵ Cf. *State ex rel. Bourdette v. Gaslight Co.*, 49 La. Ann. 1556; 22 So. 815 (construing a provision that the

books shall be "kept for public inspection" to mean inspection by persons having a real interest therein).

⁶ Cf. *Butterfly-Terrible Gold Mining Co. v. Brind* (Colo.), 91 Pac. 1101 (transferee under a transfer which the company had refused to register not entitled to avail of statutory right without showing that transfer was in accord with any by-laws that may have been adopted); *Hollister v. De Forest Wireless Tel. Co.*, 47 N. Y. Misc. 674; 94 N. Y. Supp. 504.

doubtless be treated as a shareholder for this purpose.¹ But according to a recent decision of the Appellate Division of the New York Supreme Court, a mere temporary administrator appointed to hold the assets pending the determination of a caveat to a will has no such right.² Two out of the five judges of the court united in a strong dissenting opinion. A registered transferee of shares is entitled notwithstanding the fact that the transfer was without consideration or colorable.³

§ 1108. **Conditions to Exercise of Statutory Right.** — Where a statute confers upon stockholders a right, which in its terms is unlimited and absolute, of inspecting some particular book, such as a register of shareholders, the court cannot read conditions into the act; and consequently an applicant for inspection, who is entitled by the terms of the statute, is not bound to assign some reasonable ground for exercising the privilege,⁴ and may indeed assert his right irrespective of his motive in so doing⁵ and even though he is acting in the interest of a rival company.⁶ But a sweeping provision that “the stockholders

¹ *Re Hastings*, 106 N. Y. Supp. 938.

² *Re Hastings*, 105 N. Y. Supp. 834.

³ *People ex rel. Harriman v. Paton*, 20 Abb. N. C. (N. Y.) 172.

⁴ *Holland v. Dickson*, 37 Ch. D. 669. See also *Foster v. White*, 86 Ala. 467; 6 So. 88.

⁵ *Cf. Rex v. Clear*, 4 B. & C. 899 (where the preamble of the statute was relied upon by the court); *People ex rel. Lorge v. Consolidated Nat. Bank*, 105 N. Y. App. Div. 409; 94 N. Y. Supp. 173.

But see *Commonwealth v. Empire Pass. Ry. Co.*, 134 Pa. St. 237; 19 Atl. 629; *Regina v. London, etc. Docks Co.*, 44 L. J. Q. B. 4; *State ex rel. O'Hara v. National Biscuit Co.* (N. J.), 54 Atl. 241.

⁶ *Ellsworth v. Dorwart*, 95 Iowa 108; 63 N. W. 588; 58 Am. St. Rep. 427; *Johnson v. Langdon*, 135 Cal. 624; 67 Pac. 1050; 87 Am. St. Rep. 156; *People ex rel. Callanan v. Keeseville, etc. R. R. Co.*, 106 N. Y. App. Div. 349; 94 N. Y. Supp. 555;

People ex rel. McDonald v. U. S. Mercantile Rep. Co., 20 Abb. N. C. (N. Y.) 192 (semble); *People ex rel. Harriman v. Paton*, 20 Abb. N. C. (N. Y.) 195.

Cf. Lawshe v. Royal Baking Powder Co., 104 N. Y. Supp. 361 (where a desire to obtain the names of stockholders for the purpose of buying stock from them or of selling stock to them was held a legitimate motive); *Hub Const. Co. v. New England Breeders' Club* (N. H.), 67 Atl. 574 (holding that petition is good against demurrer without setting out motive but not deciding whether unworthiness of motive could be set up as defence); *People ex rel. Hunter v. Nat. Park Bank*, 107 N. Y. Supp. 369 (holding that the court has a discretion to refuse to aid by mandamus a shareholder who is acting from an improper motive); *People ex rel. Althause v. Giroux Consol. Mines Co.*, 107 N. Y. Supp. 188 (similar point); *Althause v. Giroux*, 107 N. Y. Supp. 193.

⁷ *Mutter v. Eastern, etc. Ry. Co.*,

of all private corporations shall have the right of access to the books, records and papers of the corporation," might well be held to be subject to the implied limitation that the right "shall not be exercised from idle curiosity or for improper or unlawful purposes."¹ Of course, any statutory right of inspection is subject to the implied condition that it can be exercised only in a reasonable manner and with a due regard to the use which the corporation and the other shareholders have a right to make of the books and documents in question.² A general provision that the books of corporations shall be "kept for public inspection" must necessarily be confined in its application to inspection by shareholders or other persons having an actual interest in the information to be acquired, and actuated not by mere curiosity but by some laudable motive.³ A statutory provision in general terms giving the shareholders a right to inspect the books and papers of corporations will be construed as supplementary to the common law and not merely declaratory thereof, and hence will not be subject to all the conditions and qualifications attached to the common-law right.⁴

§ 1109. **Whether Statutory Right is Exclusive of Common-Law Right.** — The question arises whether the statutory rights of examining corporate books and papers are to be deemed exclusive and as abrogating the common-law rights of shareholders, or are to be taken as additional thereto. The matter must

38 Ch. D. 92; *Regina v. Wilts, etc.* Navigation, 29 L. T. 922.

Cf. *People ex rel. Harriman v. Paton*, 20 Abb. N. C. (N. Y.) 172.

¹ *Foster v. White*, 86 Ala. 467, 469; 6 So. 88 (semble); *Stone v. Kellogg*, 165 Ill. 192; 46 N. E. 222; 56 Am. St. Rep. 240; *Meysenberg v. People*, 88 Ill. App. 328.

Cf. *Regina v. Grand Canal Co.*, 1 Ir. L. R. 337; *Cobb v. Lagarde* (Ala.), 30 So. 326; 129 Ala. 488; *Clawson v. Clayton* (Utah), 93 Pac. 729 (right exercisable without showing reasonable grounds, but, semble, the improper motive of the complainant may be set up as a defence).

But see *State ex rel. Spinney v. Sportsmen's Park Ass'n*, 29 Mo. App. 326; *State ex rel. Wilson v. St. Louis,*

etc. Ry. Co., 29 Mo. App. 301; *Cincinnati Volksblatt Co. v. Hoffmeister*, 62 Oh. St. 189; 56 N. E. 1033; 78 Am. St. Rep. 707; 48 L. R. A. 732; *Weihenmayer v. Bitner*, 88 Md. 325; 42 Atl. 245; 45 L. R. A. 446.

² *State ex rel. Wilson v. St. Louis, etc. Ry. Co.*, 29 Mo. App. 301, 308.

See also *infra*, § 1111.

³ *State ex rel. Bourdette v. Gaslight Co.*, 49 La. Ann. 1556; 22 So. 815.

⁴ *Foster v. White*, 86 Ala. 467, 469 (headnote inadequate); 6 So. 88; *Cincinnati Volksblatt Co. v. Hoffmeister*, 62 Oh. St. 189 (headnote inadequate); 56 N. E. 1033; 78 Am. St. Rep. 707; 48 L. R. A. 732.

depend on the scope of the statute; but the tendency is to regard the statutory rights as supplementary to the common-law rights rather than as substitutions for them.¹

§ 1110. **By-laws affecting Statutory Right.** — Where a right to examine corporate books is given by statute, a by-law or regulation of the company attempting to restrict or obstruct the right would of course be invalid.² Hence, a by-law providing that the transfer books shall be closed for thirty days prior to the annual meeting of the company will be construed to mean merely that the books shall be closed against the entering of further transfers in them and not that they shall be closed against the inspection of the shareholders in derogation of their statutory rights.³

§ 1111. **Incidents of Right of Inspection — Manner of exercising Right.** — The right to inspect books, records, or documents, however that right was created, whether created by statute or existing at common law — carries with it certain incidents or concomitants, without which the right would be of little value. Thus, the right of inspection ordinarily includes a right to take copies of any of the papers inspected,⁴ subject of course to rea-

¹ *People ex rel. Stobo v. Eadie*, 63 Hun 320; 18 N. Y. Supp. 53 (affirmed on opinion below in 133 N. Y. 573; 30 N. E. 1147); *Re Steinway*, 159 N. Y. 250; 53 N. E. 1103; 45 L. R. A. 461; *Re Sage*, 70 N. Y. 220; *People ex rel. Hatch v. Lake Shore, etc. R. R. Co.*, 11 Hun (N. Y.) 1, 5-6 (semble); *Cockburn v. Union Bank*, 13 La. Ann. 289 (headnote inadequate); *State ex rel. Doyle v. Laughlin*, 53 Mo. App. 542; *People ex rel. Lorge v. Consolidated Nat. Bank*, 105 N. Y. App. Div. 409; 94 N. Y. Supp. 173; *Varney v. Baker* (Mass.), 80 N. E. 524 (headnote misleading); *State ex rel. Walkins v. Donnell Mfg. Co.* (Mo.), 107 S. W. 1112.

But see *People ex rel. Clason v. Nassau Ferry Co.*, 86 Hun (N. Y.) 128; 33 N. Y. Supp. 244 (holding that a shareholder who has a statu-

tory right to a sworn statement of the company's affairs cannot insist upon a personal inspection of the company's account books unless and until he has demanded the statutory statement).

² *State ex rel. Burke v. Citizens' Bank*, 51 La. Ann. 426; 25 So. 318. Cf. *Hodgens v. United Copper Co.* (N. J.), 67 Atl. 756.

³ *State ex rel. Wilson v. St. Louis, etc. Ry. Co.*, 29 Mo. App. 301.

⁴ *Nelson v. Anglo-American Land Co.* (1897), 1 Ch. 130; *Mutter v. Eastern, etc. Ry. Co.*, 38 Ch. D. 92; *Swift v. State ex rel. Richardson*, 7 Houst. (Del.) 338, 343-344 (headnote inadequate); 6 Atl. 856; 32 Atl. 143; 40 Am. St. Rep. 127; *Cincinnati Volksblatt Co. v. Hoffmeister*, 62 Oh. St. 189; 56 N. E. 1033; 78 Am. St. Rep. 707; 48 L. R. A. 732;

sonable restrictions as to the time to be occupied in the process; but if the statute provides that copies may be demanded on payment of a certain sum for every hundred words required to be copied, any implied right to take copies without making such payment is excluded.¹ Moreover, the right may be exercised by an agent or deputy² — for example, through a solicitor³ or expert accountant.⁴ Or the inspection may be made in company with an attorney and a stenographer.⁵ Moreover, the right is not exhausted by one examination, but may be exercised re-

Cotheal v. Brouwer, 5 N. Y. 562; *Re Martin*, 62 Hun (N. Y.) 557; 17 N. Y. Supp. 133; *People ex rel. Lorge v. Consolidated Nat. Bank*, 105 N. Y. App. Div. 409; 94 N. Y. Supp. 173; *Varney v. Baker* (Mass.), 80 N. E. 524; *Althause v. Giroux*, 107 N. Y. Supp. 191; *Burn v. London & South Wales Coal Co.*, 7 Times L. R. 118.

But see *Commonwealth v. Empire Pass. Ry. Co.*, 134 Pa. St. 237; 19 Atl. 629; *People ex rel. Althause v. Giroux Consol. Mines Co.*, 107 N. Y. Supp. 188.

¹ *Balaghat Gold Mining Co.* (1901), 2 K. B. 665 (overruling *Boord v. African Consolidated, etc. Co.* (1898), 1 Ch. 596).

² *Cincinnati Volksblatt Co. v. Hoffmeister*, 62 Oh. St. 189, 199; 56 N. E. 1033; 78 Am. St. Rep. 707; 48 L. R. A. 732; *State ex rel. Martin v. Bienville Oil Works Co.*, 28 La. Ann. 204; *Mitchell v. Rubber Reclaiming Co.*, 24 Atl. Rep. 407 (N. J.); *Foster v. White*, 86 Ala. 467; 6 So. 88.

Cf. *Latimer v. Herzog Teleseme Co.*, 75 N. Y. App. Div. 522; 78 N. Y. Supp. 314 (holding that where the application for inspection is made through an attorney, a power of attorney must be produced); *People ex rel. McDonald v. U. S. Mercantile Rep. Co.*, 20 Abb. N. C. (N. Y.) 192 (holding that the application must be made in person); *West Devon Great Consols Mine*, 27 Ch. D. 106 (declaring that the right

is personal to the shareholder and does not extend to his solicitor or agents); *Bevan v. Webb* (1901), 2 Ch. 59 (a case relating to a partnership or unincorporated company and disapproving the case last cited).

³ *Credit Co.*, 11 Ch. D. 256.

⁴ *Phoenix Iron Co. v. Commonwealth*, 113 Pa. St. 563; 6 Atl. 75; *State ex rel. Burke v. Citizens' Bank*, 51 La. Ann. 426; 25 So. 318; *Clawson v. Clayton* (Utah), 93 Pac. 729 (where the applicant although himself an accountant was allowed to exercise the right by another expert).

Cf. *Garcin v. Trenton Rubber Mfg. Co.* (N. J.), 60 Atl. 1098 (where the shareholder being a former manager of the company and familiar with its methods of bookkeeping was denied the assistance of an expert accountant); *People ex rel. McInnes v. Columbia Bag Co.*, 103 N. Y. App. Div. 208; 92 N. Y. Supp. 1084 (refusing the applicant more than one expert); *Clarke v. Eastern Bldg., etc. Ass'n*, 89 Fed. 779, 782 (headnote inadequate); *Varney v. Baker* (Mass.), 80 N. E. 524.

The compensation of the expert is of course chargeable to the applicant and not to the company. *State ex rel. Burke v. Citizens' Bank*, 51 La. Ann. 426, 433; 25 So. 318.

⁵ *Ellsworth v. Dorwart*, 95 Iowa 108; 63 N. W. 588; 58 Am. St. Rep. 427; *State ex rel. Johnson v. St. Louis Transit Co.* (Mo.), 100 S. W. 1126 (stenographer).

peatedly.¹ The right of inspecting the books does not entitle the shareholder to compel the corporation by mandamus to keep the books within the state.² Doubtless, the right of inspection must always be exercised at reasonable times³ and in a reasonable manner; and hence the court will not allow the examination to be protracted over a period of several months where there is nothing to show that so long a time is necessary.⁴

§ 1112-§ 1115. *Enforcement of Right — Remedies for Denial.*

§ 1112. **Mandamus.** — The means of enforcing a right to inspect books or documents of a corporation are the same whether the right itself be conferred by statute, or by regulations of the company, or exist at common law. If the corporation or its officers deny the right, or obstruct the free exercise thereof, mandamus will lie on the relation of the party aggrieved to compel the corporation to do its duty;⁵ and it has been

¹ *Cincinnati Volksblatt Co. v. Hoffmeister*, 62 Oh. St. 189, 199 (headnote inadequate); 56 N. E. 1033; 78 Am. St. Rep. 707; 48 L. R. A. 732.

² *Pratt v. Meriden Cutlery Co.*, 35 Conn. 36.

³ *Weihenmayer v. Bitner*, 88 Md. 325, 334 (headnote inadequate — where the statute provided that the books should be open "at all times"); 42 Atl. 245; 45 L. R. A. 446; *State ex rel. Wilson v. St. Louis, etc. Ry. Co.*, 29 Mo. App. 301, 308; *State ex rel. Spinney v. Sportsmen's Park Ass'n*, 29 Mo. App. 326 (holding that the burden of proving that inspection was demanded at an unreasonable time rests on the corporation).

Cf. *People ex rel. Lorge v. Consolidated National Bank*, 105 N. Y. App. Div. 409; 94 N. Y. Supp. 173; *Clawson v. Clayton* (Utah), 93 Pac. 729 (declaring that the right may be exercised at any time during business hours).

⁴ *People ex rel. McInnes v. Co-*

lumbia Bag Co., 103 N. Y. App. Div. 208; 92 N. Y. Supp. 1084.

⁵ *State ex rel. Wilson v. St. Louis, etc. Ry. Co.*, 29 Mo. App. 301; *Commonwealth v. Phoenix Iron Co.*, 105 Pa. St. 111; 51 Am. Rep. 184; *State ex rel. Bruning v. Hoboken Printing, etc. Co.* (N. J.), 50 Atl. 906; 67 N. J. Law 119; *Fuller v. Alexander Hollander & Co.* (N. J.), 47 Atl. 646; 61 N. J. Eq. 648; 88 Am. St. Rep. 456; *Cockburn v. Union Bank*, 13 La. Ann. 289 (substantially overruling *Hatch v. City Bank*, 1 Rob. (La.) 470, headnote misleading); *Neubert v. Armstrong Water Co.*, 211 Pa. St. 582; 61 Atl. 123; *Wyoming Coal Mining Co. v. State ex rel. Kennedy* (Wyo.), 87 Pac. 337; *Gavin v. Pacific Coast & Union* (Cal.), 84 Pac. 270; *Hub Const. Co. v. New England Breeders' Club* (N. H.), 67 Atl. 574; *Hodgens v. United Copper Co.* (N. J.), 67 Atl. 756; *State ex rel. Walkins v. Donnell Mfg. Co.* (Mo.), 107 S. W. 1112 (pendency of equity suit in which some of the same relief

held that mandamus will lie against the officer or agent having custody of the documents, the corporation not being a necessary party defendant to the proceeding.¹ Indeed, where a statute imposes upon the transfer agent of foreign corporations the duty of exhibiting the transfer books to shareholders, a writ of mandamus to enforce that duty should, it has been said, run against the transfer agent only and not the corporation or its directors.² But wherever the duty rests upon the corporation and not upon the officer alone, the better practice is to make the company a defendant; for if an officer is the only defendant, the plaintiff may be greatly embarrassed by his resignation or by the expiration of his term of office.³

The fact that the applicant may have demanded from the company and prayed from the court an inspection of docu-

might be had by way of discovery no bar).

Cf. *People v. Throop*, 12 Wend. (N. Y.) 183; *State ex rel. Fears v. New Orleans, etc. Exchange*, 112 La. 868; 36 So. 760 (plaintiff in mandamus who has sold his shares cannot appeal).

But see *Winter v. Baldwin*, 89 Ala. 483; 7 So. 734. Cf. *Re Sage*, 70 N. Y. 220; *Regina v. London, etc. Docks Co.*, 44 L. J. Q. B. 4; *People ex rel. McDonald v. U. S. Mercantile Rep. Co.*, 20 Abb. N. C. (N. Y.) 192.

¹ *Swift v. State ex rel. Richardson*, 7 Houst. (Del.) 338; 6 Atl. 856; 32 Atl. 143; 40 Am. St. Rep. 127; *Johnson v. Langdon*, 135 Cal. 624; 67 Pac. 1050; 87 Am. St. Rep. 156; *People ex rel. Muir v. Throop*, 12 Wend. (N. Y.) 183; *Cobb v. Lagarde* (Ala.), 30 So. 326; 129 Ala. 488; *Weihenmayer v. Bitner*, 88 Md. 325; 42 Atl. 245; 45 L. R. A. 446.

Cf. *State ex rel. Bergethal v. Bergethal*, 72 Wisc. 314; 39 N. W. 566; *Winter v. Baldwin*, 89 Ala. 483; 7 So. 734; *State v. Pan American Co.* (Del.), 61 Atl. 398 (misjoinder of officers as defendants no defect); *State ex rel. English v. Lazarus* (Mo.), 105 S. W. 780 (where the writ was granted against resident officers of a

foreign corporation); *People ex rel. Harriman v. Paton*, 20 Abb. N. C. (N. Y.) 195 (holding that where plaintiff is uncertain which of two persons is transfer agent, the writ may run against both); *Merrill v. Suffa* (Colo.), 93 Pac. 1099 (held improper to combine in one application for a writ of mandamus prayers for inspection of the books of several companies of each of which the defendant is secretary and the complainant a stockholder).

But see *State ex rel. Watkins v. North Am. Land, etc. Co.*, 105 La. 379; 29 So. 910.

² *People ex rel. Hatch v. Lake Shore, etc. R. R. Co.*, 11 Hun 1, 4-5 (semble).

Cf. *Winter v. Baldwin*, 89 Ala. 483; 7 So. 734.

³ *Egilbert v. Superior Court* (Cal.), 91 Pac. 748 (holding that officer who has resigned before the peremptory writ is issued cannot be punished for contempt for failing to furnish the books to plaintiff for inspection according to the terms of the writ); *Bauter v. Superior Court* (Cal.), 91 Pac. 749 (holding that in such a case the successor who was not a party to the suit cannot be punished for contempt).

ments, some of which he was not entitled to see, does not justify the corporation or the court in refusing to give him access to such of the documents as he had a right to inspect.¹ But some demand at a proper time followed by a refusal is a prerequisite to the issuance of the writ.² That the demand was made on the treasurer instead of on the secretary, who was the custodian of the book in question, will not necessitate a refusal of the writ where the company's denial of the demand was not placed upon that ground.³ Where the demand was made upon the company's clerk who referred the applicant to the managing committee and the committee said they would take time to consider, there was held to be no refusal of the application sufficient to justify a mandamus.⁴

§ 1113. **Bill in Equity.**—Another remedy which, according to the better view, is available and which is perhaps more efficacious is by bill in equity for an injunction to restrain the company and its directors from interfering with the plaintiff's inspection of the documents in question at any reasonable time.⁵ Where the right is sought to be enforced by bill in equity, the court has the power to grant the relief *ex parte* on the filing of the bill; but, unless the most pressing necessity is shown, it will refuse to do so until the defendant can be heard.⁶

§ 1114. **Action for Damages.**—A third remedy which is perhaps legally possible is an action at law for damages against the corporation or its officers for wrongfully interfering with the plaintiff in the exercise of his legal right.⁷ A resort to this

¹ *Ellsworth v. Dorwart*, 95 Iowa L. R. A. 732. Cf. *Coquard v. Nat. Linseed Oil Co.*, 171 Ill. 480; 49 108; 63 N. W. 588; 58 Am. St. Rep. 427. But see *Rosenfeld v. Einstein*, 46 N. J. Law 479.

² *People ex rel. Bishop v. Walker*, 9 Mich. 328; *Rex v. Wilts, etc. Navigation*, 3 Ad. & El. 477.

³ *Re Martin*, 62 Hun (N. Y.) 557; 17 N. Y. Supp. 133.

⁴ *Rex v. Wilts Canal, etc. Navigation*, 3 Ad. & El. 477. Cf. *Lozier v. Saratoga Gas Co.*, 59 N. Y. App. Div. 390; 69 N. Y. Supp. 247.

⁵ *Holland v. Dickson*, 37 Ch. D. 669; *Cincinnati Volksblatt Co. v. Hoffmeister*, 62 Oh. St. 189; 56 N. E. 1033; 78 Am. St. Rep. 707; 48

L. R. A. 732. Cf. *Coquard v. Nat. Linseed Oil Co.*, 171 Ill. 480; 49 N. E. 563.

But see contra: *Fuller v. Hollander & Co.*, 61 N. J. Eq. 648; 47 Atl. 646; 88 Am. St. Rep. 456; *Trimble v. Am. Sugar Ref. Co.*, 61 N. J. Eq. 340; 48 Atl. 912; *Stettauer v. N. Y., etc. Construction Co.*, 42 N. J. Eq. 46; 6 Atl. 303.

Cf. *Maeder v. Buffalo Bill's Wild West Co.*, 132 Fed. 280.

⁶ *Ranger v. Champion Cotton-Press Co.*, 51 Fed. 61.

⁷ *Bourdette v. Seward*, 107 La. 258; 31 So. 630.

remedy, however, is rarely expedient, since the difficulty of proving adequate damages would be very great. For instance, loss by reason of depreciation in the value of the plaintiff's shares caused by mismanagement which, had the plaintiff been allowed to examine the books, he might have discovered and stopped, is not recoverable.¹ It has been held that the error of the secretary in refusing an application for inspection of the books cannot be imputed to the company so as to make it liable in damages.²

§ 1115. **Statutory Fine.** — Sometimes statutes impose a penalty or fine upon the officer who denies the right of inspection,³ or upon the corporation which neglects or refuses to exhibit the required documents. The penalty imposed by such a statute is not incurred where the agent in charge of the company's office told the applicant that the book might be inspected at the private office of the president, which was only a short distance away;⁴ those facts disclose neither a refusal nor a neglect to exhibit the book. Nor is an officer of the company liable to the statutory penalty if the corporation does not keep any such book as the statute contemplates.⁵ A statutory penalty consisting in a fine payable to the state cannot be enforced in an action by a shareholder.⁶ Where the statute imposes a fine upon the company and its officers for any refusal of the right of inspection, cumulative penalties are not incurred where the right is demanded and refused on several successive days;⁷ for the refusal is treated as a single one.

¹ *Legendre & Co. v. Brewing Ass'n*, 45 La. Ann. 669, 672; 12 So. 837; 40 Am. St. Rep. 243 (semble). 3 Ad. & El. 477; *Kirkman v. Carlstadt Chemical Co.*, 36 N. Y. Misc. 822; 74 N. Y. Supp. 865.

² *Legendre & Co. v. Brewing Ass'n*, 45 La. Ann. 669; 12 So. 837; 40 Am. St. Rep. 243. *Sed quære.* ⁵ *Billingham v. Gleason Mfg. Co.*, 43 N. Y. Misc. 681; 88 N. Y. Supp. 398.

³ *Lewis v. Brainerd*, 53 Vt. 519; *Cotheal v. Brouwer*, 5 N. Y. 562; *Gould v. Olympic Min. Co.*, 96 N. Y. Supp. 455; 49 N. Y. Misc. 612 (officer not liable to penalty unless book in his possession at time of demand). ⁶ *Billingham v. Gleason Mfg. Co.*, 43 N. Y. Misc. 681; 88 N. Y. Supp. 398.

⁷ *Cox v. Paul*, 175 N. Y. 328; 67 N. E. 586.

But see *Gould v. Olympic Min. Co.*, 96 N. Y. Supp. 455; 49 N. Y. Misc. 612.
⁴ *Lozier v. Saratoga Gas Co.*, 59 N. Y. App. Div. 390; 69 N. Y. Supp. 247.

Cf. *Rex v. Wilts, etc. Navigation*,

§ 1116. **Provisions for securing Publicity in corporate Affairs otherwise than by opening Books to Inspection.** — The degree of publicity in corporate affairs which the legislature is pleased to require is often enforced in some other way than by giving to the shareholders or creditors a right to inspect the company's books. Indeed, this is very proper, for as already stated, to give to the shareholders a power of examining any and all of the company's books is tantamount, in the case of any large corporation, to throwing the company's innermost affairs open to all the world. Frequently, the legislature requires the publication of periodical balance-sheets. In England, these audits must be gone over by auditors specially appointed for the purpose; and the publication of a false balance-sheet is severely punishable. Of course, no internal regulation adopted by the company can thwart the statutory publicity. As, however, the object of the publicity statutes is thought to be a disclosure that the condition of the company is at least as good as stated, it seems that the statutory auditors may be forbidden by the articles of association of an English company to disclose the amount of a reserve fund maintained by the company.¹ It is a little difficult to reconcile one's self to the entire soundness of this dictum; for it leaves the public to speculate as to the true condition of the company — the very thing the statute was intended to prevent. If the dictum is law, persons interested in the company are free to represent that the statutory report published by the auditors is a mere form and that the true condition of the company is by reason of a large reserve fund vastly better and more worthy of credit than the report would indicate. At any rate, a provision in the articles forbidding the auditors to disclose anything in regard to the reserve fund is void;² for the fund may be invested in such a way as to involve the company in very great loss beyond the extinction of the reserve fund itself, so that the true condition of the company might be even worse than the report of the auditors, if made in accordance with such articles, would disclose.

Sometimes, by statute, the failure to make the required reports and accounts subjects the directors to individual liability

¹ *Newton v. Birmingham Small Arms Co.* (1906), 2 Ch. 378, 387 *Arms Co.* (1906), 2 Ch. 378. (semble).

for the debts of the corporation; but the law relating to the enforcement of that species of penalty lies outside the scope of this treatise.¹ Sometimes other penalties are provided. In the case of insurance, banking, and other financial corporations, regulations looking toward publication of their true condition are naturally apt to be more stringent.

§ 1117. **Constructive Notice of Books and Records.**—As already stated, the books and records of a corporation, even of a quasi-public corporation such as a railway company, are in no sense public documents as to non-members. Hence, persons who deal with a corporation are not chargeable with notice of facts which its records disclose,² or even of its by-laws.³ Not even the directors of a company can be charged with constructive notice of the contents of its books.⁴

¹ See *infra*, § 1649, and *Ford River Lumber Co. v. Perron* (Mich.), 111 N. W. 1074. ³ *Supra*, § 732. As to constructive notice of the incorporation paper, see *supra*, § 161, § 162.

² *Blair v. St. Louis, etc. R. R. Co.*, 25 Fed. 684. ⁴ *Infra*, § 1538.

CHAPTER XIX

PROOF OF CORPORATE MATTERS — BOOKS AND RECORDS AS EVIDENCE

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§ 1118. **Validity and Proof of unrecorded and parol Votes and Resolutions.** — The votes and resolutions of shareholders or directors need not be in writing, but are quite valid although they rest merely in parol. And while prudence, convenience, and custom all dictate that the proceedings either of shareholders or of directors shall be reduced to writing or recorded in formal books of minutes, yet a failure to do so in no respect impairs their validity.¹ This is as true of a resolution appoint-

¹ *Knight's Case*, 2 Ch. 321, 327 *Rubber Co.*, 19 N. J. Eq. 402; *Mc-*
(approved in Great Northern Salt, etc. Michael v. Brennan, 31 N. J. Eq.
Works, 44 Ch. D. 472, 483); *Hand-* 496; *Bank of Kentucky v. Schuylkill*
ley v. Stutz, 139 U. S. 417; 11 Sup. *Bank*, 1 Pars. Eq. Cas. (Pa.) 180,
 Ct. 530; *Wells v. Rahway White* 262-263; *Benbow v. Cook*, 115 N.

ing an agent as of other resolutions¹ (except possibly in cases where the appointment is required to be in writing by the statute of frauds) even where the agent is appointed to execute a specialty.² And so, too, a resolution that is duly entered on the minutes may be rescinded by a subsequent parol resolution of which no record is made.³

Where a resolution was not originally in writing and has not subsequently been reduced to writing in the minutes, it follows necessarily that the contents or substance of the resolution as well as the fact of its passage may be proved by parol.⁴ So, also, parol evidence is admissible to show how many votes were cast pro or con, upon any question, and by whom they were given.⁵

All this is true although a statute may expressly direct that records shall be kept by corporations.⁶

Car. 324, 331; 20 S. E. 453; 44 Am. St. Rep. 454; *Edgerly v. Emerson*, 3 Foster (N. H.) 555; 55 Am. Dec. 207; *Cram v. Bangor House Proprietary*, 12 Me. 354; *Oakford v. Fischer*, 75 Ill. App. 544; *Goodwin v. U. S. Annuity, etc. Co.*, 24 Conn. 591 (semble); *Wood v. Wiley Construction Co.*, 56 Conn. 87; 13 Atl. 137; *Masonic, etc. Ass'n v. Severson*, 71 Conn. 719; 43 Atl. 192; *Sheldon Canal Co. v. Miller* (Tex.), 90 S. W. 206 (headnote inadequate).

But see contra: *Dennis v. Joslin Mfg. Co.*, 19 R. I. 666; 36 Atl. 129; 61 Am. St. Rep. 805; *Hume v. Eagon*, 83 Mo. App. 576 (where the common-law rule had been altered by express statute).

Cf. *Savings Bank v. Davis*, 8 Conn. 191, 204; *Pittsburgh, etc. R. R. Co. v. Clarke*, 29 Pa. St. 146, 152; *Cornwall, etc. Mining Co. v. Bennett*, 5 H. & N. 423 (as to resolution making a call).

As to by-laws, see § 688.

¹ *Robinson Reduction Co. v. Johnson*, 10 Colo. App. 135; 50 Pac. 215.

² See supra, § 483.

³ *Whittington v. Farmers' Bank*, 5 H. & J. (Md.) 489.

⁴ *McMichael v. Brennan*, 31 N. J. Eq. 496; *Wells v. Rahway Rub-*

ber Co., 14 N. J. Eq. 402; *Bank of Ky. v. Schuykill Bank*, 1 Pars. Eq. Cas. (Pa.) 180, 262-264; *Hudson v. Parker Machine Co.*, 173 Mass. 242; 53 N. E. 867; *Ten Eyck v. Pontiac, etc. R. R. Co.*, 74 Mich. 226; 41 N. W. 905; 16 Am. St. Rep. 633; 3 L. R. A. 378; *Beach v. Stouffer*, 84 Mo. App. 395; *Richardson v. St. Joseph Iron Co.*, 5 Blackf. (Ind.) 146; 33 Am. Dec. 460; *Edgerly v. Emerson*, 3 Foster (N. H.) 555; 55 Am. Dec. 207; *Robinson Reduction Co. v. Johnson*, 10 Colo. App. 135; 50 Pac. 215; *Moss v. Averill*, 10 N. Y. 449; *Weber v. Fickey*, 52 Md. 500; *Murray v. Beal*, 65 Pac. 726; 23 Utah 548; *Birmingham Ry., etc. Co. v. Birmingham Traction Co.*, 29 So. 187; 128 Ala. 110.

But see *Pittsburgh, etc. R. R. Co. v. Clarke*, 29 Pa. St. 146, 152.

⁵ *Ten Eyck v. Pontiac, etc. R. R. Co.*, 74 Mich. 226; 41 N. W. 905; 16 Am. St. Rep. 633; 3 L. R. A. 378; *Ismon v. Loder*, 97 N. W. 769; 135 Mich. 345.

⁶ *Zalesky v. Iowa, etc. Ins. Co.*, 102 Iowa 512 (headnote inadequate); 70 N. W. 187; 71 N. W. 433; *Sampson v. Bowdoinham, etc. Corp.*, 36 Me. 78.

Cf. *Du Quoin Star, etc. Co. v.*

§ 1119-§ 1126. MINUTES OF MEETINGS OF SHAREHOLDERS
AND DIRECTORS AS EVIDENCE.

§ 1119. **Scheme of Treatment.** — When a resolution or other vote has been entered on the minutes, the question arises, first, whether such minutes are competent evidence, and second, whether, assuming them to be admissible, they are to be deemed the best evidence so as to shut out other proof unless their non-production be accounted for.

§ 1120-§ 1123. *Whether Minutes are admissible as Evidence.*

§ 1120. **In general.** — Sometimes the minutes are expressly declared by statute to be good evidence.¹ Independently of such provisions, they would always be admissible *against* the company as admissions made by officers or agents of the company in the course of their duty.² Hence, an entry in the book of minutes may constitute a sufficient memorandum to take a contract out of the Statute of Frauds as against the company,³ or may constitute a "contract in writing" within the meaning of a statute prescribing a longer period of limitations for actions upon written contracts than upon oral contracts.⁴ Even in favor of the corporation, minutes may perhaps be received in evidence at common law as entries made in the course of business. As against members of the corporation, it has been thought that corporate books and minutes partake of the nature of public documents, and as such are admissible in evidence.⁵ But in respect to mere

Thorwell, 3 Ill. App. 395 (where a record was required to be kept by the company's articles of organization).

But see *Corcoran v. Sonora Mining, etc. Co.*, 71 Pac. 127; 8 Idaho 651.

¹ See *Sigua Iron Co. v. Brown*, 171 N. Y. 488; 64 N. E. 194.

² See *Hayward v. Pilgrim Society*, 21 Pick. (Mass.) 270, where, however, the admissibility of the record was not placed upon this ground.

³ *Tufts v. Plymouth Gold Mining*

Co., 14 Allen (Mass.) 407; *Chesapeake, etc. Ry. Co. v. Deepwater Ry. Co.*, 50 S. E. 890, 905; 57 W. Va. 641 (semble).

⁴ *Texas Western Ry. Co. v. Gentry*, 69 Tex. 625, 630-631; 8 S. W. 98.

⁵ *Commonwealth v. Woelper*, 3 Serg. & R. (Pa.) 29; 8 Am. Dec. 628.

Cf. *Farwell v. Houghton Copper Works*, 8 Fed. 66; *Ridgway v. Farmers' Bank*, 12 Serg. & R. (Pa.) 256, 262-263; 14 Am. Dec. 681; *Hager v. Cleveland*, 36 Md. 476, 494;

industrial corporations, this idea seems far-fetched. Very clearly, corporate books cannot be received as evidence against members of the company on the principle by which firm books are admissible against a partner; for the cases as to partnerships go on the ground that the clerk who made the entries was agent for every partner, while a secretary or clerk of a corporation is not an agent for the several shareholders.¹

Some authorities have declared that the reception of the records, minutes, etc., as evidence in favor of the company is in derogation of the common law and can only be sustained by virtue of some statute.² So, where a statute makes the minutes evidence if signed by the chairman, they are held in England not to be receivable unless his signature be attached.³ But, as already intimated, the use of corporate books as evidence may, it is submitted, often be justified by common-law principles as contemporaneous entries made in the course of business or duty; and this is particularly true in America where the "shop-book rule," by which a party's own shop-books are admissible in his favor to prove the delivery of goods to a customer,⁴ has familiarized lawyers and the courts with a relaxation of the modern English rules of evidence. At all events, wherever the proceedings of shareholders or directors are in issue, corporate books of minutes are generally received in America, without any direct statutory authority, as evidence in favor of the company,⁵ or

Trainor v. German-American Bldg. Ass'n, 204 Ill. 616; 68 N. E. 650; *Hayden v. Williams*, 96 Fed. 279, 281-282; 37 C. C. A. 479.

¹ *Hill v. Manchester, etc. Water Works Co.*, 5 B. & Ad. 866, 875; *Rudd v. Robinson*, 126 N. Y. 113; 26 N. E. 1046; 22 Am. St. Rep. 816; 12 L. R. A. 473.

But see *Chesapeake, etc. Ry. Co. v. Deepwater Ry. Co.*, 50 S. E. 890, 905-906; 57 W. Va. 641 (semble).

As against an officer or agent who had custody of the books, they may perhaps be received in evidence on this ground. Cf. *infra*, § 1127.

² Cf. *infra*, § 1128 and note.

³ *Cornwall, etc. Mining Co. v. Bennett*, 5 H. & N. 423 (headnote inadequate).

⁴ See 2 Wigmore on Evidence, § 1536 et seq.

⁵ *Farwell v. Houghton Copper Works*, 8 Fed. 66; *Smith v. Natchez Steamboat Co.*, 1 How. (Miss.) 479; *Abernethy v. Church of the Puritans*, 3 Daly (N. Y.) 1, 5 (semble); *Booth v. Dexter Steam Fire Engine Co.*, 118 Ala. 369; 24 So. 405; *People v. Oakland County Bank*, 1 Doug. (Mich.) 282; *Heintzelman v. Druid's Relief Ass'n*, 38 Minn. 138; 36 N. W. 100; *Bank of Ky. v. Schuylkill Bank*, 1 Pars. Eq. Cas. (Pa.) 180, 260-263; *Olney v. Chadsey*, 7 R. I. 224; *North River, etc. Co. v. Shrewsbury Church*, 22 N. J. Law 424; 53 Am. Dec. 258; *Wood v. Coosa, etc. R. Co.*, 32 Ga. 273; *Hamilton, etc. Co. v. Rice*, 7 Barb. (N. Y.) 157; *Vawter v. Frank-*

a *fortiori* in favor of either party in controversies between third persons;¹ and it is submitted that their admission is conducive, and indeed necessary, to the ends of justice. If the admissibility of such evidence cannot be explained, as above suggested, on the principle of entries in the course of business, or under the *res gestæ* rule, then it must be justified *ex necessitate*, as a special exception to the hearsay rule.

Books of a company have been received in evidence where the fact of incorporation is the very point in issue.² And indeed records of promoters or corporators prior to incorporation have been received.³ A statute declaring that minutes shall be evidence of the proceedings that take place at the meeting makes the minutes evidence in a criminal prosecution against two of the directors for the purpose of showing that they were present at a certain meeting.⁴

§ 1121. **Requisites of valid and admissible Minutes.** — In general, in order that a book of minutes may be admissible, the entries must be contemporaneous or nearly so with the matters recorded. To be sure, the minutes are not rendered inadmissible because they were written up at leisure from rough notes taken at the meeting, and were not actually signed until the next meeting.⁵ But, on the other hand, a narrative in the

lin College, 53 Ind. 88; *Fleming v. Wallace*, 2 Yeates (Pa.) 120; *First Baptist Church v. Harper*, 191 Mass. 196; 77 N. E. 778 (books of unincorporated society with statutory powers).

But see *Chesapeake, etc. Ry. Co. v. Deepwater, etc. Ry. Co.*, 50 S. E. 890; 57 W. Va. 641.

In *Highland Turnpike Co. v. McKean*, 10 Johns. (N. Y.) 154, 156; 6 Am. Dec. 324, the court said: "The general rule is (and it is a rule of evidence essential to public convenience), that corporation books are evidence of the proceedings of the corporation."

¹ *Harrison v. Morton*, 83 Md. 456, 474-475; 35 Atl. 99; *Coffin v. Collins*, 17 Me. 440.

But see *Hager v. Cleveland*, 36 Md. 476, 494.

Cf. *Hall v. Carey*, 5 Ga. 239.

² *Duke v. Cahawba Nav. Co.*, 10 Ala. 82; 44 Am. Dec. 472; *McFarlan v. Triton Ins. Co.*, 4 Denio (N. Y.) 392; *Hudson v. Carman*, 41 Me. 84; *People ex rel. Platt v. Oakland Co. Bank*, 1 Doug. (Mich.) 282 (proceeding to forfeit a charter).

See also *supra*, § 273. Cf. *First Baptist Church v. Harper*, 191 Mass. 196; 77 N. E. 778.

³ *Glenn v. Liggett*, 47 Fed. 472, 478-479.

⁴ *Regina v. Staples*, 19 Vict. L. R. 47.

⁵ *Southampton Dock Co. v. Richards*, 1 Man. & Gr. 448; *Re Jennings*, 1 Ir. Ch. 236.

See also *West London Ry. Co. v. Bernhard*, 1 Dav. & Mer. 397; *Miles v. Bough*, 3 G. & D. 119; *Ex parte Stock*, 33 L. J. Ch. 731.

minutes of one meeting of transactions that took place at a previous meeting would not be competent evidence.

Of course, it is not necessary in order to render the minutes admissible that they be under the corporate seal.¹

§ 1122. **Of what Minutes are Evidence.** — Generally, it may be stated that the minutes are not evidence of anything except the proceedings of the meeting of which they purport to give a record.² However, where a written contract that was approved by a shareholders' meeting was copied into the minutes of that meeting, and was afterwards lost, the minutes were held to be competent secondary evidence of that contract when it came collaterally in issue in a controversy between outside parties.³

§ 1123. **Minutes not Evidence unless Transaction they record is Relevant.** — It should be added by way of caution that the minutes will never be admissible unless the fact which they record is relevant. For instance, where the dismissal of a servant by the directors is a fact to be proved, the minutes of the directors' meeting may be received in evidence to establish the dismissal; but if the company were suing the servant for misconduct, the fact of his subsequent dismissal by the directors would not be competent evidence on behalf of the company, and hence the minutes would not be evidence.

§ 1124. **Whether Minutes are the "Best Evidence" of Corporate Proceedings.** — By some authorities the minutes have been declared to be not merely competent evidence, but even the technical "best evidence" of corporate proceedings, so as to exclude any other proof of such proceedings until the non-production of the minutes is explained.⁴ But, it should be

¹ *Fleming v. Wallace*, 2 Yeates (Pa.) 120 (headnote inadequate).

³ *Harrison v. Morton*, 83 Md. 456, 474-475; 35 Atl. 99.

² *Glenn v. Liggett*, 47 Fed. 472, 479 (report of treasurer to directors copied in minutes held inadmissible); *Edwards v. Bates County*, 117 Fed. 526, 537 (copy of a court record transcribed in minutes held inadmissible).

Cf. *Culver v. Third Nat. Bank*, 64 Ill. 528.

⁴ *Harrison v. Morton*, 83 Md. 456, 474; 35 Atl. 99 (semble); *Smith v. Natchez Steamboat Co.*, 1 How. (Miss.) 479 (semble); *People v. Oakland County Bank*, 1 Doug.

observed, the fact to be proved is not the contents of a written document, — not the contents of the minutes, — but matters resting in parol, namely, the fact that this or that action was taken by the meeting — of which the minutes are a mere narrative.¹ Accordingly, it is submitted that on principle the best evidence rule has no application;² and, after all, the authority to the contrary consists very largely of mere dicta. On the other hand, where the fact to be proved is not the passage of a resolution, or the like, but the contents of the minutes, either as the ultimate fact in issue or as a link in a chain of evidence, the record itself is clearly the best evidence, so that even an examined copy thereof is not admissible unless the non-production of the original is accounted for.³ So, where a by-law is in writing,

(Mich.) 282, 285 (semble); *Dennis v. Joslin Mfg. Co.*, 19 R. I. 666; 36 Atl. 129; 61 Am. St. Rep. 805; *Edgerly v. Emerson*, 3 Foster (N. H.) 555, 566; 55 Am. Dec. 207 (semble); *St. Helen Mill Co.*, 3 Sawy. 88, 92 (semble); *Hurd v. Hotchkiss*, 72 Conn. 472, 479-480; 45 Atl. 11; *United Gold Mining Co. v. Rocky Mountain Nat. Bank*, 2 Colo. 565, 575; *Mullanphy Sav. Bank v. Schott*, 135 Ill. 655; 26 N. E. 640; 25 Am. St. Rep. 401; *Coffin v. Collins*, 17 Me. 440; *Pittsburgh, etc. R. R. Co. v. Clarke*, 29 Pa. St. 146, 152; *Central Electric Co. v. Sprague Electric Co.*, 120 Fed. 925; 57 C. C. A. 197; *Nixon v. Goodwin* (Cal.), 85 Pac. 169, 175.

Cf. *Beach v. Stouffer*, 84 Mo. App. 395; *High Court v. Zak*, 136 Ill. 185; 26 N. E. 593; 29 Am. St. Rep. 318; *New York, etc. R. R. Co. v. Offield*, 78 Conn. 1; 60 Atl. 740; *Boggs v. Lakeport, etc. Ass'n*, 111 Cal. 354; 43 Pac. 1106 (declaring that only the formally drawn up minutes are the best evidence of the proceedings, and that, where no formal minutes had been prepared, rough notes of minutes were as much secondary evidence as the testimony of witnesses); *Tobin v. Roaring Creek, etc. R. R. Co.*, 86 Fed. 1020; *Garmany v. Lawton*, 124 Ga. 876; 53 S. E. 669;

110 Am. St. Rep. 207 (parol evidence admitted on proof that the minutes, if any ever existed, had been lost); *Prentiss Tool & Supply Co. v. Godchaux*, 66 Fed. 234, 236; 13 C. C. A. 420 (where the court emphasized the fact that the corporation was not required by statute or by-law to keep official books of minutes); *Wigmore on Evidence*, § 1223.

¹ Professor Wigmore, however, argues that "the record is not somebody's hearsay testimony to the act; it is the act itself." Wigmore on Evidence, § 1074 (3), § 1661.

² Cf. *Johnson v. Okerstrom*, 70 Minn. 303; 73 N. W. 147; *Franklin Trust Co. v. Rutherford Electric Co.*, 57 N. J. Eq. 42; 41 Atl. 488 (affirmed in 58 N. J. Eq. 584; 43 Atl. 1098); *Barrell v. Lake View Land Co.*, 122 Cal. 129; 54 Pac. 594; *Zimmerman v. Masonic Aid Ass'n* 75 Fed. 236, 238; *Blanton v. Kentucky Distilleries, etc. Co.*, 120 Fed. 318, 337-338; *Stovell v. Alert Gold Mining Co.* (Colo.), 87 Pac. 1071 (parol proof to show who was an officer of corporation); *Partridge v. Badger*, 25 Barb. (N. Y.) 146 (election of directors provable by testimony of witness who was present).

³ *Ridgway v. Farmers' Bank*, 12

and not merely reduced to writing after its adoption, the non-production of the original by-law must be explained before parol evidence of its contents can be received.¹

§ 1125. **Contradicting Minutes by extraneous Evidence.** — At all events, whether the minutes are, technically, the best evidence of what went on at the meeting, they are certainly only *prima facie* and not conclusive evidence thereof.² Extraneous parol proof is always receivable, not merely to explain the minutes, but to show errors in them. In every case the inquiry should be as to what really happened at the meeting and not as to what the minutes indicate to have happened: the minutes are merely of evidential value and may always be contradicted. But in one Rhode Island case it was declared that as between shareholders and the company the records of the corporation are con-

Serg. & R. (Pa.) 256; 14 Am. Dec. 681.

Cf. *Shea v. Mabry*, 1 Lea (Tenn.) 319, 334-335 (headnote inadequate); *Coppes v. Union Nat., etc. Ass'n* (Ind.), 67 N. E. 1022 (where a statute provided that a "sworn copy" of the record should be admissible where the original would be).

See also *infra*, § 1130, and McKelvey on Evidence, § 253, pp. 344-345 (where the distinction taken in the text is clearly stated).

¹ *Lloyd v. Supreme Lodge*, 98 Fed. 66; 38 C. C. A. 654; *Lumbard v. Aldrich*, 8 N. H. 31; 28 Am. Dec. 381; *American Bldg., etc. Ass'n v. Merrick*, 39 Nebr. 413, 418-419 (headnote inadequate); 58 N. W. 107; *Greene v. Hereford* (Ariz.), 95 Pac. 105.

But see *Zimmerman v. Masonic Aid Ass'n*, 75 Fed. 236, 238.

Cf. *Supreme Lodge v. Robbins*, 70 Ark. 364; 67 S. W. 758.

² *McMichael v. Brennan*, 31 N. J. Eq. 496, 499; *Blake v. Bayley*, 16 Gray (Mass.) 531; *Goodwin v. U. S. Annuity, etc. Co.*, 24 Conn. 591, 601; *St. Louis, etc. R. R. Co. v. Tiernan*, 37 Kans. 606, 625; 15 Pac. 544; *Forrest Glen Brick, etc. Co. v. Gade*, 55 Ill. App. 181, 193-194; *Ten Eyck v. Pontiac, etc. R. R. Co.*, 74

Mich. 226; 41 N. W. 905; 16 Am. St. Rep. 633; 3 L. R. A. 378; *Middleton v. Arastraville Mining Co.*, 146 Cal. 219, 222-224; 77 Pac. 889; *Selley v. American Lubricator Co.* (Iowa), 93 N. W. 590, 591; 119 Iowa 591 (where there was said to be a rebuttable presumption that the minutes are a correct and complete narrative); *Paxton v. Heron* (Colo.), 92 Pac. 15 (evidence admitted to show that an absent director was fraudulently recorded as present).

But see *White Chimney, etc. Co. v. McMahan*, 50 S. W. Rep. 836 (Ky.) (where, however, the judgment of the court does not bear out the headnote); 21 Ky. Law Rep. 41; *Davis Mill Co. v. Bennett*, 39 Mo. App. 460; *Barrell v. Lake View Land Co.*, 122 Cal. 129; 54 Pac. 594; *Gellerman v. Atlas Foundry, etc. Co.* (Wash.), 87 Pac. 1059 (a case where the secretary had failed to strike out certain words from a by-law as intended by a resolution of the shareholders).

Cf. *McIlhenny v. Binz*, 80 Tex. 1, 9; 13 S. W. 655; 26 Am. St. Rep. 705; *Pinchback v. Mining Co.*, 137 N. Car. 171, 181-182; 49 S. E. 106; *Prentiss Tool & Supply Co. v. Godchaux*, 66 Fed. 234; 13 C. C. A. 420.

clusive, except on a direct proceeding to correct any errors in them, and that therefore they cannot be impeached on a suit to enjoin a forfeiture of shares, to collect a dividend, or the like;¹ but this decision stands confessedly unsupported by any previous authority, is contrary to the cases cited above, and, if one may venture a prediction, surely will not be followed in other states.² An entry in the minutes may, however, amount to a representation or holding out of an agent as authorized to act, so that as against innocent third persons dealing with the agent the company should not be allowed to show that his actual authority was less than his apparent authority.³

§ 1126. **Supplementing Minutes by extraneous Evidence.** — *A fortiori*, books of minutes when incomplete may be supplemented by parol testimony.⁴ Thus, where the secretary's minutes of a directors' meeting fail to show that any of the directors were present, the omission may be supplied by parol.⁵ So, where the minutes of a shareholders' meeting fail to show the presence of a quorum, it is permissible to prove by parol that some of the shareholders present did in fact hold proxies for other shareholders in sufficient numbers to make up a quorum.⁶

§ 1127. **Account Books and Ledgers of Corporations as Evidence.** — The relaxation of the rules of evidence in favor of the admissibility of corporate records extends, however, only to books of corporate records properly so called, and does not render the mere account books of a corporation evidence in its own favor,¹ or in favor of either party in a litigation between

¹ *Dennis v. Joslin Mfg. Co.*, 19 R. I. 666; 36 Atl. 129; 61 Am. St. Rep. 805.

² But see *Davis Mill Co. v. Bennett*, 39 Mo. App. 460; *Corcoran v. Sonora Mining, etc. Co.*, 71 Pac. 127; 8 Idaho 651.

³ Cf. *Manhattan Hardware Co. v. Roland*, 128 Pa. St. 119, 122; 18 Atl. 429 ("The corporation cannot deny the accuracy of its own minutes as against a party who loaned money on the faith of them"); *Wyss-Thalman v. Beaver Valley Brewing Co. (Pa.)*, 68 Atl. 187.

⁴ *Rose v. Independent Chevro-Kadisho (Pa.)*, 64 Atl. 401; *Hamill v. Royal Arcanum*, 152 Pa. 537; *Hotchkiss v. Norwood Park Bldg., etc. Ass'n (Ill.)*, 82 N. E. 257, 261.

⁵ *St. Louis Rawhide Co. v. Hill*, 72 Mo. App. 142.

⁶ *Franklin Trust Co. v. Rutherford Electric Co.*, 57 N. J. Eq. 42; 41 Atl. 488, affirmed short in 58 N. J. Eq. 584; 43 Atl. 1098.

¹ *Rudd v. Robinson*, 126 N. Y. 113; 26 N. E. 1046; 22 Am. St. Rep. 816; 12 L. R. A. 473; *Glenn v.*

third persons.¹ Such account books and ledgers are governed by the same rules as the similar books of an individual. As against the agent who made the entries, or as against a director or officer who had actual or constructive knowledge of the entries and who made no objection to their accuracy, such account books may, on strict common-law principles, be received in evidence as admissions.²

§ 1128-§ 1130. *Stock Books and Lists and Registers of Shareholders and Transfers.*

§ 1128. **Admissibility.** — Stock books, or transfer books, or lists or registers of shareholders, are another kind of corporate records which are often used as evidence, and are admissible either by statute or at common law for much the same reasons as books of minutes. As share registers are in large measure designed to enable the company to determine who are entitled to dividends, the corporation must be protected in paying dividends to the registered shareholders, unless a shareholder's name is absent from the register through the company's own fault. To an extent, therefore, sufficient to afford such protection, such registers must be admissible in evidence in controversies between the corporation and its shareholders or creditors. So, too, as will be shown below, the register of shareholders is very material, and is indeed generally conclusive, as to the parties entitled to vote at corporate meetings. To the extent required by this rule, each shareholder must be taken to have assented on becoming a member of the company that his right to vote shall depend on the state of the register, and that the register may be received as evidence for that purpose. The

Liggett, 47 Fed. 472, 479-480; *Bank*, 93 Ala. 599; 9 So. 299; 30 *Trainor v. German-American Bldg. Ass'n*, 204 Ill. 616; 68 N. E. 650; Am. St. Rep. 87.

Coppes v. Union Nat., etc. Loan Ass'n (Ind.), 69 N. E. 702. ² *Olney v. Chadsey*, 7 R. I. 224; *First Nat. Bank v. Tisdale*, 84 N. Y. 655. Cf. *People v. Burnham*, 104

N. Y. Supp. 725; 106 N. Y. Supp. 57 (account books of corporation not evidence for the state in criminal prosecution against officer who is not shown to have been cognizant of the entries).

¹ *Terry v. Birmingham Nat.*

other class of cases in which the list of shareholders is commonly resorted to as evidence is in suits by the corporation for the enforcement of calls, or by its creditors for the enforcement of the shareholders' statutory liability, where the defendant denies that he is a shareholder, or where there is a question whether the capital has been fully subscribed.

Such lists or registers are made evidence by express statute in England¹ and in some of the United States;² and in other American states they are held to be admissible at common law.³ In England, however, it is thought that the admissibility of share registers in favor of the company is contrary to the common law and is allowable only by statute. Thus, Lord Lindley says: "The rule that a register or official return shall be evidence in favor of a company making or keeping it is contrary to general principles of evidence and is a great privilege, and in order to enjoy this privilege the register or return must be kept or made as required by the statute making it evidence."¹

¹ See *infra*, p. 922, note 1.

² Cf. *Union Nat. Bank v. Scott*, 53 N. Y. App. Div. 65; 66 N. Y. Supp. 145.

³ *Finn v. Brown*, 142 U. S. 56, 67 (headnote inadequate); 12 Sup. Ct. 136; *Turnbull v. Payson*, 95 U. S. 418 (distinguished in federal cases cited in next paragraph of this note); *Hammond v. Straus*, 53 Md. 1, 15-16 (headnote inadequate); *Weber v. Fickey*, 52 Md. 500; *Marlborough Branch R. R. Co. v. Arnold*, 9 Gray (Mass.) 159; 69 Am. Dec. 279; *Penobscot R. R. Co. v. Dummer*, 40 Me. 172; 63 Am. Dec. 654; *Penobscot R. R. Co. v. White*, 41 Me. 512; 66 Am. Dec. 257; *Pittsburgh, etc. R. R. Co. v. Applegate*, 21 W. Va. 172; *Hoagland v. Beall*, 36 Barb. (N. Y.) 57; *Glenn v. Liggett*, 47 Fed. 472; *Louisville, etc. R. R. Co. v. Hart County*, 75 S. W. 288; 25 Ky. Law Rep. 395; *State ex rel. Columbia Valley R. R. Co. v. Superior Court* (Wash.), 88 Pac. 332; *State ex rel. Biddle v. Superior Court* (Wash.), 87 Pac. 40; *Glenn v. Springs*, 26 Fed. 494.

But see *Philadelphia, etc. R. R.*

Co. v. Hickman, 28 Pa. St. 318; *Mudgett v. Horrell*, 33 Cal. 25; *Chase v. Sycamore, etc. R. R. Co.*, 38 Ill. 215; *Foot v. Anderson*, 123 Fed. 659 (headnote inadequate); *National Express, etc. Co. v. Morris*, 15 App. D. C. 262 (where a distinction was taken between admitting the books as evidence against one who has proved by evidence *aliunde* to be a shareholder and admitting them to prove a certain person to be a shareholder); *Girard Life Ins., etc. Co. v. Loving* (Kans.), 81 Pac. 200 (same point as last case); *Sigua Iron Co. v. Greene*, 88 Fed. 207, 213-214 (same point); *Carey v. Williams*, 79 Fed. 906; 25 C. C. A. 227; *Harrison v. Remington Paper Co.*, 140 Fed. 385, 401-402; 72 C. C. A. 405 (books admitted but only because defendant proved by extraneous evidence to have assented to them).

¹ 1 Lindley on Companies, 6th ed., 75-76.

See also *Birkenhead, etc. Ry. Co. v. Brownrigg*, 4 Ex. 426, 429 (per Alderson, B.).

Said Lord Brougham in *Bain v.*

§ 1129. **Requisites of Stock Books and Lists or Registers.** — As to registers of shareholders, it is not always indispensable that the entries be original, or contemporaneous, or nearly so, with the facts recorded. For the register of members performs so important an office in the management of the company that if it be lost or mislaid a new list must be made out from such data as may be accessible to the corporation. If, therefore, the original register of shareholders is destroyed or misplaced, the company may direct a new register to be prepared which when duly drawn up may be used for the same purposes as the book which it is intended to replace.² So, if the company has never had a regular stock book, a book prepared to serve that purpose from entries in a "cash ledger" and other available sources has all the effect of a stock book.³ The fact that the new book is not composed of original contemporaneous entries goes to its credibility, but not to its competency as evidence. This is certainly true where the register is made evidence by statute, and would probably also be held, from the very necessity of the case,

Whitehaven, etc. Ry. Co., 3 H. L. Cas. 1, 22: "A great privilege is bestowed by the act upon the Company, neither more nor less than that of making evidence for itself. The books of the Company are made evidence for the Company, and, unless rebutted by counter-evidence, will be sufficient to warrant a verdict in each case. It must be admitted that this is a very great privilege, and an exception to the ordinary rules of evidence. By those rules, and the rules of common sense and justice, what a man says is evidence against him but is not evidence in his favour; but here the position is reversed. So that the Company by writing in the books that 'A. B. holds' a certain number of shares, can go into court and make A. B. answerable for them and can produce the entry as evidence against him. This is a great privilege, and in order to justify the exercise of it, the conditions on which it is given, namely, the conditions of the statute as to the making of these

entries, must be strictly complied with; and I hold that it is much safer to consider each of those provisions as a condition precedent, as a provision imperative, and not merely directory, on account of the great importance of the privilege itself, and on account of its being an exception to the ordinary rules of evidence."

² *Argus Co.*, 138 N. Y. 557, 577-578.

As to stock books compiled from loose contemporaneous memoranda, see *Stuart v. Valley R. R. Co.*, 32 Gratt. (Va.) 146; *Hayden v. Atlanta Cotton Co.*, 61 Ga. 233.

³ *Cedar Grove Cemetery Co.*, 61 N. J. Law 422 (headnote inadequate); 39 Atl. 1024.

Cf. *supra*, § 173, and *infra*, § 1220. See also *Consolidated Tel., etc. Co.*, 43 Atl. Rep. 433 (N. J.). As to the admissibility of the stock-certificate book, see *Geneva Mineral Springs Co. v. Steele*, 111 N. Y. App. Div. 706, 717; 97 N. Y. Supp. 996, and *supra*, § 864.

without the aid of any statute, although the general unrelaxed common-law principles of evidence might require a different decision. Where the statute enacts that the register shall be prepared at a certain time, the provision is directory, and does not render inadmissible a register drawn up at a subsequent period.¹

§ 1130. **Secondary Evidence of Entries.** — Where a transfer book is relied upon in order to show a transfer of shares, the entry on the books is not merely evidence of the transfer, it is the transfer itself. And hence secondary evidence of the entry is not admissible unless the non-production of the book itself be accounted for.²

§ 1131. **Of proving Documents to be veritable Corporate Records as Condition of Admissibility in Evidence.** — Of course, in no case will a book purporting to contain corporate records be admissible (unless indeed it be an ancient document) without extraneous proof that it actually is the book which it purports to be³ and that the entries were made by the proper officer or some substitute in his unavoidable absence.⁴ It is not enough to prove the book to be in the handwriting of a person stated in the book itself to be the secretary.⁵ The entry, however, is good evidence, although not in the officer's handwriting, if made by a clerk under his direction and with his approval.⁶ A secretary's

¹ *Wolverhampton, etc. Co. v. Co. v. Rocky Mountain Nat. Bank, Hawksford*, 7 C. B., N. S., 795; 11 C. B., N. S., 456.

² *Gordon v. Tweedy*, 71 Ala. 202, 212; *Skowhegan Bank v. Culler*, 49 Me. 315.

Cf. *supra*, § 1124.

³ *Whitman v. Granite Church*, 24 Me. 237.

Cf. *Goodwin v. U. S. Annuity, etc. Co.*, 24 Conn. 591; *Herman v. Supreme Lodge*, 48 Atl. 1000; 66 N. J. Law 77 (as to a printed book of by-laws).

⁴ *Highland Turnpike Co. v. McKean*, 10 Johns. (N. Y.) 154; 6 Am. Dec. 324; *United Gold Mining*

Quare, whether it is necessary to call the clerk, if he be living, who made the entries, to testify to their authenticity. See *United Gold Mining Co. v. Rocky Mountain Nat. Bank*, *ubi supra*.

⁵ *Highland Turnpike Co. v. McKean*, 10 Johns. (N. Y.) 154; 6 Am. Dec. 324.

⁶ *Wells v. Rahway White Rubber Co.*, 19 N. J. Eq. 402.

Cf. *Southampton Dock Co. v. Richards*, 1 Man. & Gr. 448 (stated *infra*, § 1132); *United Growers Co. v. Eisner*, 22 N. Y. App. Div. 1;

record of the acceptance of his own resignation is admissible,¹ and conversely a newly elected secretary may record proceedings which took place at the meeting before his own election, but of which he had personal knowledge.² Mere irregularities will not render a book of records inadmissible.³ Certainly omission of the keeper of a book of minutes to subscribe his signature will not render them inadmissible in evidence.⁴ Still more clearly, the fact that the secretary who signed the minutes is interested in the result of the litigation is no ground for excluding them as evidence.⁵ The book should ordinarily come from the proper custody.⁶ The fact that a corporate record is written on loose sheets of paper and not in a bound volume is not necessarily fatal to its admissibility.⁷ It is certainly not necessary that the record be under the corporate seal.⁸

§ 1132. **Of proving Book offered in Evidence to be the Book made admissible by Statute.** — Wherever a statute is relied upon to establish the admissibility of any book of corporate records, it must of course appear that the book offered in evidence is the book meant by the statute. Thus, a statute making the register of shareholders competent evidence does not authorize the admission of some other book or paper which cannot fairly be deemed a register of shareholders although it may contain some matters appropriate or necessary in a register of shareholders. For

47 N. Y. Supp. 906; *Smith v. Natchez Steamboat Co.*, 1 How. (Miss.) 479, 492.

¹ *Evarts v. Killingworth Mfg. Co.*, 20 Conn. 447 (headnote inadequate).

² *Evarts v. Killingworth Mfg. Co.*, 20 Conn. 447, 458 (headnote inadequate).

³ *Bank of Ky. v. Schuylkill Bank*, 1 Pars. Eq. Cas. (Pa.) 180, 260.

⁴ *Woodhaven Bank v. Brooklyn Hills Imp. Co.*, 69 N. Y. App. Div. 489; 74 N. Y. Supp. 1023.

⁵ *Morgan v. Lehigh Valley Coal Co.* (Pa.), 64 Atl. 633 (semble).

⁶ See *Smith v. Natchez Steamboat Co.*, 1 How. (Miss.) 479.

⁷ Cf. *Brackett v. Persons Unknown*, 53 Me. 228; *Wyss-Thalman v. Beaver Valley Brewing Co.* (Pa.), 68

Atl. 187 (where the fact that the book did not come from, technically, the proper custody was held to be sufficiently explained to justify submitting it to the jury with an instruction that in view of the suspicious circumstances the burden rested upon the party offering it in evidence to prove by clear evidence that the book was in fact the minute-book of the company).

⁸ *Vawter v. Franklin College*, 53 Ind. 88; *Chott v. Tivoli Amusement Co.*, 114 Ill. App. 178.

But see *McConnell v. Combination Mining, etc. Co.*, 30 Mont. 239, 263; 76 Pac. 194; 104 Am. St. Rep. 703; 31 Mont. 563; 79 Pac. 248.

⁹ *Fleming v. Wallace*, 2 Yeates (Pa.) 120 (headnote inadequate).

example, loose allotment sheets which were never intended as a register of shareholders cannot be received in evidence as a register.¹ On the other hand, it is not necessary that the book should in all respects comply with the statutory requirements; it is admissible if, though irregular in some particulars, it is nevertheless intended as the book pointed out by the statute and if in the main it complies with the statutory requirements.² And the name or title of the book offered in evidence is quite immaterial if, regard being had to its contents and object, it is in substance and in fact the book made admissible by the statute.³ Similarly, where the book in question is required by statute to be kept by the secretary, it is admissible if kept under his direction, and need not be in his own handwriting.⁴ The book or paper is not rendered inadmissible because of errors or inaccuracies; such circumstances affect the weight, not the competency, of the evidence. *A fortiori*, this is true where the mistakes or omissions relate to other parts of the book than those offered in evidence.

§ 1133. **Copies of Corporate Records.** — A copy of the whole or a portion of a book of corporate records is not admissible in evidence unless the non-production of the original be first accounted for.⁵ Even if a sworn copy would be good, a copy merely certified by the secretary of the corporation is not admissible.⁶ That the copy is under the corporate seal gives it no additional effect.⁷ In some states, by statute, copies of books of certain kinds of corporations, certified by their officers, are admissible.⁸

¹ *Ex parte Cammell* (1894), 2 Ch. 392; *Wolverhampton, etc. Co. v. Hawksford*, 7 C. B., N. S., 795 (affirmed in Ex. Ch., 11 C. B., N. S., 456).

² *Southampton Dock Co. v. Richards*, 1 Man. & Gr. 448; *Wolverhampton, etc. Co. v. Hawksford*, 7 C. B., N. S., 795 (affirmed in Ex. Ch., 11 C. B., N. S., 456); *Henderson v. Royal British Bank*, 7 E. & B. 356; *Dossett v. Harding*, 1 C. B., N. S., 524; *Powis v. Harding*, 1 C. B., N. S., 533; *Daniell v. Royal British Bank*, 1 H. & N. 681; *London Grand Junction Ry. Co.*, 2 Man. & Gr. 606; *Birmingham, etc. Ry. Co. v. Locke*, 1 Q. B. 256.

³ *Weikersheim's Case*, 8 Ch. 831; *Bain v. Whitehaven, etc. Ry. Co.*, 3 H. L. Cas. 1.

⁴ *Southampton Dock Co. v. Richards*, 1 Man. & Gr. 448.

Cf. *Wells v. Rahway White Rubber Co.*, 19 N. J. Eq. 402.

⁵ *Supra*, § 1124, § 1130. Cf. *Wigmore on Evidence*, § 1223.

⁶ *Hallowell, etc. Bank v. Hamlin*, 14 Mass. 178.

Cf. *Nixon v. Goodwin* (Cal.), 85 Pac. 169. As to statutory methods of proving contents of corporate records, see *Cantwell v. Stockmen's Bldg., etc. Union*, 88 Ill. App. 247.

⁷ *Stoever v. Whitman's Lessee*, 6 Binney (Pa.) 416.

⁸ See *Wigmore on Evidence*, § 1683.

CHAPTER XX

JUDICIAL INTERVENTION IN MANAGEMENT OF CORPORATIONS — SHAREHOLDERS' BILLS

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§ 1134. **Importance of Subject.** — At the threshold of the subject of corporate management as exemplified and explained by judicial authorities, necessarily lies the question how far the courts have power to prevent and redress irregularities in such management; for there can be no judicial standard of regularity in corporate management unless the courts have the right to take cognizance of and correct departures therefrom.

§ 1135. **The Corporation alone entitled to complain of Injuries to the Corporation** — *Rule in Foss v. Harbottle.* — The fundamental principle is that for all injuries to the company, the corporation in its corporate name is the only proper party to complain in a court of law¹ or equity.² However seriously its

¹ *Smith v. Hurd*, 12 Metc. (Mass.) 371; 46 Am. Dec. 690; *Allen v. Curtis*, 26 Conn. 456; *McAleeer v. McMurray*, 58 Pa. St. 126; *Converse v. United Shoe Machinery Co.*, 185 Mass. 422; 70 N. E. 444; *Niles v. New York, etc. R. R. Co.*, 176 N. Y. 119; 68 N. E. 142; *Eldred v. Ripley*, 97 Ill. App. 503; *Dudley v. Armenia Ins. Co.*, 115 N. Y. App. Div. 380; *Wells v. Dane*, 101 Me. 67; 63 Atl. 324; *Ninneman v. Fox* (Wash.), 86 Pac. 213 (applying the same rule whether the claim of the corporation arises *ex contractu* or *ex delicto*). See also *infra*, § 1636.

² *Foss v. Harbottle*, 2 Hare 461; *Anderson v. Midland Ry. Co.* (1902), 1 Ch. 369, 375-376 (head-note inadequate); *Bayless v. Bybee*, 1 Freeman. Ch. (Miss.) 161, 175 (head-note inadequate); *Stanley v. Moore*, 17 Vict. L. R. 285; *Hersey v. Veazie*, 24 Me. 9; 41 Am. Dec. 364; *Fraser River Mining, etc. Co. v. Gallagher*, 5 Brit. Columb. 82. But see *Hunter v. Robbins*, 117 Fed. 920 (where a treasurer of a corporation was allowed to sue in his own name for an accounting by a former treasurer, although the court would have had no jurisdiction if the company had been the plaintiff).

shareholders or creditors may be damaged by a legal injury to the company, they have no individual right of action. Even the fact that a shareholder has sold his shares at a time when their market value was depressed through the defendant's wrongdoing, so that he will be unable to participate in any damages the corporation may recover, will not give him an individual cause of action.¹ The legal entity of the corporation is the only party to bring suit. The leading case in support of this truly fundamental principle is *Foss v. Harbottle*,² and the doctrine itself is often conveniently designated as the Rule in *Foss v. Harbottle*.

§ 1136. **Irregularities in Management deemed Injuries to the Corporation alone.** — With this doctrine is coupled the principle that all irregularities in corporate management, all breaches of duty on the part of the officers and directors, are injuries to the company, for which therefore it alone can sue.³ Furthermore, if the persons in control of the corporation fail to take steps, by suit or otherwise, to redress any injury to the company, that failure is itself an injury to the company of which only the company can complain. For instance, if the cashier of a bank should embezzle its funds, the dishonesty may depress the value of its shares and indirectly damage its shareholders, but is in legal contemplation a wrong committed against the corporation alone. If the directors of the company decline to sue the embezzler or his bondsmen, although in that way the loss might be recovered, they themselves commit a wrong against the company of which also (if the rule just stated be rigorously applied) only the corporation can complain. Again, if the directors permit irregularities in corporate management, — for instance, if they neglect to hold meetings as prescribed by law or the company's regulations, or if they neglect any formalities or safeguards required of them, — they are guilty of wrongs against the company, and the company only. The broad principle is that the mismanagement of a corporation, or irregularities in

¹ *Wells v. Dane*, 101 Me. 67; 63 Atl. 324; *Ninneman v. Fox* (Wash.), 86 Pac. 213. Cf. cases cited *infra*, p. 962, n. 1.

But see *Rafferty v. Donnelly*, 197 Pa. St. 423; 47 Atl. 202 (criticised *infra*, § 1637).

² *Foss v. Harbottle*, 2 Hare 461.

³ For certain exceptions, or apparent exceptions, to this principle, see *infra*, § 1152.

its management, are wrongs against the corporation, and as such can be redressed only at the company's suit.

§ 1137. **Judicial Intervention in Corporate Management not forbidden by Law.** — Sometimes it is said that the courts will not interfere in matters of internal corporate management;¹ but there is no such rule. The courts may prevent or redress any irregularities in the internal management of a corporation; but, with the exceptions stated below, such interference will be undertaken only at the suit of the corporation. To be sure, inasmuch as the parties guilty of irregularities in internal management are almost always the company's directors and officers, who, being in control of its affairs, are by no means likely to authorize a suit in the name of the company against themselves, suits in the name of a corporation on account of matters of internal management are uncommon; but nevertheless they are always legally possible.²

§ 1138-§ 1189. REMEDIES OF A SHAREHOLDER FOR INJURIES TO THE CORPORATION.

§ 1138. **In general — Remedy by Appeal to a Shareholders' Meeting.** — The principles stated in the foregoing paragraphs often lead to some hardship; but to every complaint of a shareholder against mismanagement or irregularity in the corporation the answer is, that the alleged guilty parties are his own chosen officers, and that his remedy is through the action of the majority, by which he has agreed to be bound, at some general meeting of the company. From all wrongs in the management of the corporation committed by the directors or officers the appeal is to a shareholders' meeting. This was laid down with clearness and emphasis in Vice-Chancellor Wigram's judgment in the famous case of *Foss v. Harbottle*³ which has lent its name to the doctrine now under discussion — the Rule in *Foss v. Harbottle*. Since that decision, the rule that ordinarily the only

¹ See *Burland v. Earle* (1902), A. C. 83.

² Cf. *Exeter, etc. Ry. Co. v. Buller*, 5 Eng. Ry. & Can. Cas. 211 (where in a suit in the corporate name the court enjoined the majority of the directors from disregarding a resolu-

tion of the shareholders); *Commonwealth ex rel. Lackovic v. Jankovic* (Pa.), 65 Atl. 1099 (*quo warranto* at instance of corporation to oust usurping treasurer).

³ 2 Hare 461.

recourse of shareholders who are discontented with the internal management of the company is by appeal to a general meeting has been reiterated and applied in numberless cases on both sides of the Atlantic.¹ *A fortiori* the shareholder will not be allowed to sue where general meetings have been held at which he might have submitted his grievances but which he refused to attend.² The rule prevents a suit by a shareholder to enjoin some threatened irregularity of management or other wrong to the company as well as a suit for redress of a completed wrong.³

§ 1139-§ 1141. *Remedy of Shareholder by instituting Suit in the Corporate Name on his own Authority.*

§ 1139. **In general.** — But while an appeal to a shareholders' meeting may be in theory an adequate remedy, yet practically it is very precarious. One need not wonder, therefore, that various efforts have been made to avoid the rigor of the rule in *Foss v. Harbottle*. Now, as already stated, if only the suit could be brought in the name of the company, the whole difficulty would be avoided; but, as also already stated, the corporate authorities are generally the very persons who should be made defendants, and who therefore will not consent to the use of the company's name as plaintiff. Nevertheless, discontented stockholders have sometimes, especially in England, taken the bull by the horns and brought suit in the name of the corporation as plaintiff. Where this bold course is followed, upon the face of the proceedings the suit appears properly framed, and the bill or declaration would be good on demurrer. The defendants' proper course is to move that the bill be taken from the files, or that the name of the corporation as plaintiff be stricken out, on the ground that the company did not authorize the bringing of the suit. This motion raises at the outset

¹ E. g., *Hattersley v. Earl of Co.*, 3 De G. & Sm. 293; *Taunton Shelburne*, 31 L. J. Ch. 873, 876-877; *v. Royal Ins. Co.*, 2 Hem. & Mill. 135; *Bill v. Western Union Tel. Co.*, 16 *Ide v. Bascomb*, 72 Pac. 62.

Fed. 14; *Johns v. McLester*, 137 ² *Bailey v. Birkenhead, etc. Ry.*, Ala. 283; 34 So. 174; 97 Am. St. 12 Beav. 433.

Rep. 27.

³ Cf. *Mozley v. Alston*, 1 Phillips

Other cases in which the shareholder's attempt to sue has been defeated are: *Yetts v. Norfolk Ry.* Ch. 790.
See, however, *infra*, § 1151.

the question whether or not the persons authorizing the suit have the right to use the corporate name. For obvious reasons, prudence demands that this motion be made without delay, although probably the right to make it would not be waived by general appearance or plea to the merits. Certainly, the objection must be made in the court of first instance, and cannot be made for the first time in an appellate court.¹

§ 1140. **Who can authorize or ratify Use of Name of Corporation as Plaintiff.** — Ordinarily, the regular corporate officials are the only persons having power to authorize a suit in the company's name.² Hence ordinarily, where a suit is brought in the corporate name without the express or implied sanction of the directors or managing officers, and *a fortiori* where it is brought against their express wishes, the requisite authority for using the name of the corporation is lacking.³ However, the general body of shareholders acting through a properly convened meeting have the right to authorize the use of the company's name without the consent and even against the wishes of the directors and officers.⁴ The approval of a majority of the subscribers to the memorandum of association or incorporation paper is not sufficient.⁵

§ 1141. **Practice on Motion to strike Bill from Files because of unauthorized Use of Corporate Name as Plaintiff.** — Where a bill is filed on behalf of the company without the sanction either of the directors or officers or of a majority of the shareholders, a motion to strike it from the files will be granted.⁶ If upon such a motion it appear that the suit is brought against the dissent

¹ *Anglo-Universal Bank v. Baragon*, 45 L. T. 362 (headnote inadequate).

² Cf. *Eagle Iron Co. v. Colyar*, 156 Fed. 954.

³ Cf. *Hudson River, etc. R. R. Co. v. Hay*, 14 Abb. Pr., N. S. (N. Y.), 191.

⁴ *Hamilton v. Desjardins Canal Co.*, 1 Grant (Can.) 1.

But see *Dunsmuir v. Colonist Printing & Pub. Co.*, 9 Brit. Columb. 290. Cf. *Railway Co. v. Alling*, 99 U. S. 463 (where the court refused, at the request of a majority of the shareholders, to dismiss an appeal taken in the name of the

company by order of the directors).

⁵ *La Compagnie de Mayville v. Whitley* (1896), 1 Ch. 788.

⁶ *La Compagnie de Mayville v. Whitley* (1896), 1 Ch. 788; *Wadsworth, etc. Co. v. Wright*, 18 W. R. 728; *East Pant Du, etc. Co. v. Merryweather*, 2 Hem. & Mill. 254.

Compare the ruling on the cross-bill in *Bronson v. LaCrosse R. R. Co.*, 2 Wall. 283 (headnote inadequate). See also *Silk Mfg. Co. v. Campbell*, 27 N. J. Law 539 (certiorari brought by shareholder in name of corporation dismissed).

of the directors — for example, to enjoin them from acting contrary to a resolution of the shareholders — and without the direct approval of a shareholders' meeting, the court has a discretionary power to refuse to grant the motion immediately, and may order a general meeting of the company to be held for the purpose of determining whether or not the institution of the suit in the company's name shall be ratified and approved.¹ If such a meeting approve the suit, the motion to strike out the company's name as plaintiff will be overruled, and the case will proceed to trial on the merits.² If, however, the shareholders vote to repudiate the suit, then if the company is sole plaintiff, the bill must be taken off the file;³ and if there are co-plaintiffs, the company's name must be stricken out as complainant.⁴ In the latter event, the company may by amendment be made defendant if the case be one in which on the principles shortly to be stated a shareholder might sue in his own name.⁵ And conversely, if the company has been made defendant when it should have been plaintiff, the error may be corrected by amendment.⁶ In passing on the question whether the shareholders have ratified the filing of the bill, the interested shareholders are entitled to vote, and their votes must be counted even in respect to shares which the bill charges that they obtained from the company by fraud, since the court cannot decide the merits of the case on a mere motion to take the bill off the files.⁷ If on motion the bill is taken off the file or the company's name stricken out, the solicitor who purported to appear for the corporation may be ordered to pay the company's costs as between solicitor and client, and the defendants' costs as between party and party.⁸ The filing of such a bill in the name

¹ *Pender v. Lushington*, 6 Ch. D. 70, 79. See also *Exeter & Crediton Ry. Co. v. Buller*, 16 L. J. Ch. 449; 5 Eng. Ry. & Can. Cas. 211; *White v. Shaw*, 21 Vict. L. R. 559 (holding that the court in granting the opportunity to take the sense of a general meeting may impose such conditions as it thinks will do justice between the parties).

² Ratification of the unauthorized act of an attorney in bringing suit for the company may be effective even though the objection had

previously been made by the defendant. *Massachusetts Const. Co. v. Kidd*, 142 Fed. 285.

³ *East Pant, etc. Co. v. Merryweather*, 2 Hem. & Mill. 254.

⁴ *Silber Light Co. v. Silber*, 12 Ch. D. 717.

⁵ *Silber Light Co. v. Silber*, 12 Ch. D. 717.

⁶ *Duckett v. Grover*, 6 Ch. D. 82.

⁷ *East Pant, etc. Co. v. Merryweather*, 2 Hem. & Mill. 254.

⁸ *Newbiggin-by-the-Sea Gas Co. v. Armstrong*, 13 Ch. D. 310; *Gold*

of the corporation is, therefore, somewhat hazardous, and a prudent solicitor, before incurring the risk, would insist on some provision by his clients for his indemnity.

§ 1142-§ 1187. *REMEDY OF SHAREHOLDER BY SUIT IN HIS OWN NAME.*

§ 1142-§ 1163. *WHEN A SHAREHOLDER MAY SUE IN HIS OWN NAME.*

§ 1142. **General Principle** — **Shareholder allowed to sue where Ends of Justice require.** — The daring course of filing a bill in the company's name without the authority of the directors, in the hope that a general meeting, being ordered by the court, will ratify the proceeding, may in some instances be good strategy; but the expedient is at best precarious, and often proves delusive. Yet although, as stated above, all irregular or wrongful management of a corporation is in legal contemplation a wrong against the company only, nevertheless the shareholders are in point of fact injured thereby. Hence, although the rule requiring the suit to be brought in the company's name is far from a mere technicality, yet one would expect that a court of equity might under some circumstances permit a shareholder suing in his own name to bring the matter before the courts, wherever substantial justice can be done in no other way. Accordingly, Vice-Chancellor Wigram, in *Foss v. Harbottle*, although laying down the general rule in terms so emphatic as to have become classic, nevertheless very clearly indicated the exception. "If," said he, "a case should arise of injury to a corporation by some of its members, for which no adequate remedy remained, except that of a suit by individual corporators in their private characters, and asking in such character the protection of those rights to which in their corporate character they were entitled, I cannot but think that * * * the claims of justice would be found superior to any difficulties arising out of technical rules respecting the mode in which corporations are required to sue."¹ So, then, a shareholder

Recfs of Western Australia v. Dawson (1897), 1 Ch. 115.

¹ *Foss v. Harbottle*, 2 Hare 461, 492.

Cf. *La Compagnie de Mayville v. Whitley* (1896), 1 Ch. 788.

may sue in his own name where the claims of justice demand and where no other adequate remedy exists for the wrong which the corporation has suffered. This, however, is a principle rather than a rule, and is of slight assistance to a practising lawyer. Hence it is necessary to ascertain from the decisions in what classes of cases the courts conclude that justice does require that the shareholder be permitted to sue. Such a suit by a shareholder is commonly called a shareholder's suit.

§ 1143-§ 1148. *Suits on account of Wrongs committed by a Majority of the Shareholders against the Corporation.*

§ 1143. **In general — Right of Minority Shareholder to sue.** — The clearest case for allowing a shareholder to sue in his own name is where the wrong to the corporation has been committed by the majority of the company. In such a case, obviously, a suit in the name of the company is impossible; for the majority being alone entitled to permit the use of the company's name as plaintiff will naturally refuse to authorize a suit against themselves. Hence, unless the wrong is to go without remedy, a minority shareholder must be allowed to sue in his own name. The only alternative would be to require him first to file a bill to obtain leave to sue in the company's name, and then, having obtained such leave, to bring suit in the corporate name to redress the wrong. But this would protract litigation and multiply suits in a manner totally foreign to equitable principles.¹ Hence, where the majority of the company have committed or are threatening to commit a wrong to the company, — for example, a fraud on its rights, — a minority shareholder may proceed in equity in his own name to redress or prevent the wrong.² In order to bring the case within this

¹ *Atwool v. Merryweather*, 5 Eq. 104 Mass. 378; *Nathan v. Tompkins*, 464 n., 468 n. 82 Ala. 437; 2 So. 747; *Rogers v.*

² *Atwool v. Merryweather*, 5 Eq. *Nashville, etc. Ry. Co.*, 91 Fed. 299; 464 n.; *Menier v. Hooper's Tel. 33 C. C. A. 517; Peabody v. Flint, Works*, 9 Ch. 350; *Alexander v. 6 Allen 52 (semble); Miner v. Belle Automatic Telephone Co.* (1900), *Isle Ice Co.*, 93 Mich. 97; 53 N. W. 2 Ch. 56; *Mason v. Harris*, 11 Ch. 218; 17 L. R. A. 412; *Sage v. D. 97; Neall v. Hill*, 16 Cal. 145, *Culver*, 147 N. Y. 241; 41 N. E. 513; 151 (headnote inadequate); 76 Am. *Sellers v. Phoenix Iron Co.*, 13 Fed. Dec. 508; *Brewer v. Boston Theatre*, 20; *Kern v. Arbeiter, etc. Verein*,

principle, the wrongdoers must be in control at the time the suit is brought, as it is not enough for them to have been in control when the wrong was perpetrated.¹ It is sufficient to allege in general terms that the wrongdoers own a majority of the shares without stating the number of shares owned by each;² but it is not enough to charge that the wrongdoers are in control of the corporation.³

§ 1144. **Necessity for proving Majority guilty of a legal Wrong.** — In the application of this principle it should be borne in mind that wherever the majority are acting within their rights as defined by law and the constitution of the company, no such suit can be maintained, not because of the rule in *Foss v. Harbottle*, but because no legal injury has been committed, either against the corporation or against any one else. As Lord Davey said in delivering the opinion of the Privy Council in a recent case, the fact that a suit is brought in the name of a shareholder rather than in the name of the company is “mere matter of procedure in order to give a remedy for a wrong which would otherwise escape redress, and it is obvious that in such an action the plaintiffs cannot have a larger right to relief than the company itself would have if it were plaintiff, and cannot complain of acts which are valid if done with the approval of the majority of the shareholders, or are capable of being confirmed by the majority.”⁴ Thus, where the majority act honestly and within the powers of the corporation, whatever they do is within their own discretion, so that no one — neither the company nor the minority shareholders — has any right to complain.⁵ Without here attempting to explain in greater detail the extent of the powers of the majority,⁶ suffice it to say that

102 N. W. 746; 139 Mich. 233; *Sloan v. Clarkson* (Md.), 66 Atl. 18; *Cann v. International Trust Co.*, 40 Nova Scotia 65 (headnote inadequate).

¹ *Kessler v. Ensley Co.*, 123 Fed. 546, 558-559; *Flynn v. Brooklyn City R. R. Co.*, 158 N. Y. 493, 509.

² *O'Conner v. International Silver Co.*, 59 Atl. (N. J.) 321.

³ *Ainsworth v. Evans* (Ariz.), 80 Pac. 344.

But see *Polhemus v. Polhemus*, 114 N. Y. App. Div. 781, 782; 100 N. Y. Supp. 263 (where it seems to

have been held that such an allegation is sufficient).

⁴ *Burland v. Earle* (1902), A. C. 83, 93.

⁵ *Burland v. Earle* (1902), A. C. 83.

⁶ See *infra*, § 1296-§ 1300. Cf. *Dodd v. Pittsburgh, etc. R. R. Co.* (Ky.), 106 S. W. 787 (where the wrong on the part of the majority consisted in so mismanaging the company that another corporation was enabled to obtain a judgment against it which the first company was obliged to pay).

wherever the majority of the company do something which they ought not to do, or leave undone something which they ought to do, a minority shareholder will be allowed to sue in equity to obtain redress for the wrong to the company.

A very recent English case is hard to reconcile with this principle. The majority of a company had passed resolutions altering its articles of association, but the meeting at which these resolutions were passed was not convened by such notice as was required by the company's existing regulations. The court (Kekewich, J.) refused to enjoin the company, at the suit of a minority shareholder, from acting under the amended articles, and pointed out that a minority shareholder had never been allowed to sue for a wrong committed by the majority except where the majority had acted fraudulently or had exceeded the powers of the corporation.¹ True it is that ordinarily a majority of a company when acting honestly and not *ultra vires* of the corporation are guilty of no wrong; but where the powers of the majority are restricted by the incorporation paper, or in England by the articles of association, it is difficult to see why a majority who violate those restrictions do not commit a wrong against the company as much as if they had acted fraudulently or in a manner exceeding the powers of the corporation itself. And if the majority have committed a wrong against the company, the principle above stated would seem to support a shareholder's bill.

§ 1145. **Refusal of Majority to sue in Corporate Name for Injury by Third Person as Foundation for a Shareholder's Suit.** — Where a wrong has been committed against the company by some person other than the holders of a majority of the shares, or a person with whom they are in connivance, some decisions would indicate that a shareholder may sue to obtain the redress which is due to the company, provided the company refuses on request to institute the appropriate action or suit in the corporate name.² Such, however, is submitted not to be

¹ *Normandy v. Ind, Coope & Co. Northern Pac. Ry Co.*, 155 Fed. 445, 448-449 (shareholder in railway company allowed to sue to enjoin enforcement of rates fixed by a statute alleged to be unconstitutional and confiscatory, where the directors refused to sue because of

² Cf. *Kavanaugh v. Commonwealth Trust Co.*, 181 N. Y. 121; 73 N. E. 562; *Whitney v. Hazard*, 101 N. W. (S. Dak.) 346; *Hazard v. Durant*, 11 R. I. 195; *Perkins v.*

the law. For in general, where a cause of action has accrued to a corporation for a tort or a breach of contract, the majority may determine whether or not it is advisable to sue. A thousand different circumstances may properly enough influence them to refrain from enforcing even a clear right of action. Whatever their decision, if honestly reached, it is conclusive; it constitutes no wrong to the company and gives the minority shareholders no ground of suit.¹ For instance, if directors or promoters abuse their fiduciary relation and by fraud or concealment obtain contracts from the company, the majority of the shareholders may, if they choose, decide to take no steps towards rescinding the transaction or holding the promoters or directors responsible for their profits; and in so doing they commit no wrong, and therefore give the minority shareholders no right to maintain a shareholder's bill.² It is apprehended that the same principle would apply even if the directors or officers had been guilty of acts *ultra vires* of the company. If such *ultra vires* acts have been fully executed, a cause of action accrues to the company, which it may or may not choose to enforce, in

the severity of the penalties which might be imposed if the effort to have the statute declared unconstitutional should prove unsuccessful).

¹ *Samuel v. Holladay*, 1 Woolwich 400, 417-420. "It is not always best to insist upon all one's rights; and a corporation acting by its directors, or by vote of its members, may properly refuse to bring a suit which one of its stockholders believes should be prosecuted. In such a case the will of the majority must control. It is only when the action of a corporation in refusing to proceed at the request of a stockholder is fraudulent as against him, or in disregard of its rights, that he can maintain a suit in his own name in the corporate right." *Dunphy v. Traveller Newspaper Co.*, 146 Mass. 495, 497; 16 N. E. 426; per Knowlton, J.

See also *Corbus v. Alaska, etc. Mining Co.*, 187 U. S. 455, 463 (headnote inadequate); 23 Sup. Ct. 157; *Terry v. Eagle Lock Co.*, § 374.

47 Conn. 141; *Kessler v. Ensley Co.*, 123 Fed. 546; *Pittsburgh, etc. Ry. Co. v. Dodd*, 72 S. W. 822, 827; 24 Ky. Law Rep. 2057; 74 S. W. 1096; 115 Ky. 176 (a peculiar case, where the minority shareholder was allowed to sue because the claim against the wrongdoer involved the same questions as a claim of the company against the majority shareholders); *Kessler & Co. v. Ensley Co.*, 129 Fed. 397; *Wallace v. Lincoln Savings Bank*, 89 Tenn. 630; 15 S. W. 448; 24 Am. St. Rep. 625; *McCloskey v. Snowden*, 212 Pa. 249; 61 Atl. 796; 108 Am. St. Rep. 867; *Hendrickson v. Bradley*, 85 Fed. 508; 29 C. C. A. 303 (where the company refused to sue on the ground that the suit if brought would be unsuccessful); *Bond v. Gray Improvement Co.*, 102 Md. 426; 62 Atl. 827; *Poor v. Iowa Central Ry. Co.*, 155 Fed. 226 (where the ground of the refusal did not appear).

² See *infra*, § 1591, and *supra*,

the discretion of the majority of the shareholders. In omitting or refusing to sue in the corporate name, even for such a cause of action, the majority act within their rights, do no wrong to the company, and therefore do not open the way for a suit by minority shareholders.¹

Of course, however, if the omission or refusal of the majority to bring suit on any cause of action is fraudulent and not *bona fide* for the best interests of the corporation, the majority then commit a wrong against the company so that, on the principle stated above, a minority shareholder may sue.² And in order to prevent multiplicity of suits, a court of equity on such a bill takes cognizance of all the matters complained of, including the original wrong to the company for which the majority improperly refused to seek redress on the corporation's behalf.³ So, of course, if the majority have themselves committed the wrong for relief against which they refuse to proceed, they cannot take shelter behind their discretionary power to decline to institute legal proceedings, but, as we have stated above, the way is opened at once for a shareholder's suit.⁴ Moreover, there may be cases where the company's interests so obviously demand that relief against a third person for some wrong done to the company be sought through litigation, if obtainable in no other way, that a refusal of the majority to institute proceedings will be regarded as in the nature of a fraud or *ultra vires* act, even though no proof of actual corruption be forthcoming, and will consequently be deemed a wrong committed by them against the company, and will justify a shareholder's suit.⁵ As stated above, the complaining shareholder must in such cases request the corporate authorities — the directors and majority

¹ *Nankivell v. Benjamin*, 18 Vict. L. R. 543, and *infra*, § 1155.

But see *Siegmán v. Electric Vehicle Co.*, 140 Fed. 117 (action against former directors for paying dividends out of capital in violation of statute); *Siegmán v. Electric Vehicle Co.* (N. J.), 65 Atl. 910 (headnote inadequate — a similar action).

² *Weidenfeld v. Sugar Run, R. R. Co.*, 48 Fed. 615, 619-620; *Kessler & Co. v. Ensley Co.*, 129 Fed. 397.

³ See *Lund v. Blanshard*, 4 Hare 9.

⁴ See *Alexander v. Automatic Telephone Co.* (1900), 2 Ch. 56; *Nathan v. Tompkins*, 82 Ala. 437; 2 So. 747; and also *supra*, § 1143.

⁵ See *Greenwood v. Freight Co.*, 105 U. S. 13, 15-16; *Hazard v. Durant*, 11 R. I. 195, 204-207; *Groel v. United Electric Co.* (N. J.), 61 Atl. 1061 (where the bill alleged and the plea admitted that promoters had received \$20,000 in secret profits for which they were accountable to the company).

shareholders—to sue in the company's name; for until they have refused to do so, they are not connected with the wrong.¹ It is in such cases that the much-talked-of “demand” of the complaining shareholder on the corporate authorities to bring suit is material.² The object of a demand that suit be brought in the corporate name is to establish the fact that the persons on whom the demand is made are not acting *bona fide* for the best interests of the company, but are guilty of a wrong against it.

§ 1146. **Condonation by Majority of the Innocent Shareholders of Wrong committed by Majority of all the Shareholders.**—In some cases where the majority of the shareholders have committed a fraud against the company there may be a question whether the interests of the company would not after all be best subserved by ratifying the fraudulent transaction and condoning the fraud. Nevertheless, it has been held that the court has no power to direct a meeting to be held to decide this question at which the fraudulent shareholders shall have no vote, and that accordingly a court of equity should rescind the fraudulent transaction at the suit of any shareholder.³ It would seem, however, that where the opinion of a majority of the honest members is already known, their wishes should be respected, even if thereby the fraudulent transaction be allowed to stand, unless, of course, the interests of the company so plainly demand rescission that a failure to rescind would be itself a fraud.

§ 1147. **Whether Minority Shareholder must appeal to General Meeting before suing in his own Name on account of Injury committed by Majority.**—Wherever an injury to the company has been committed by the majority of its members and officers, the minority shareholders are not required, before filing their bill, to make a demand on the officers to bring suit in the corporate name or to appeal to a general meeting to do so.⁴ A general

¹ Perhaps persistent failure to seek redress for an open and notorious wrong may be equivalent to a refusal to sue, even though no demand to bring suit has been made. Cf. *Williams v. Erie Mountain, etc. Co.* (Wash.), 91 Pac. 1091. All that is necessary is to satisfy the court that a demand, if made, would certainly have been refused.

² As to what constitutes a

sufficient “demand,” see *infra*, § 1158.

³ *Mason v. Harris*, 11 Ch. D. 97.

⁴ *Harding v. American Glucose Co.*, 182 Ill. 551, 629; 55 N. E. 577; 74 Am. St. Rep. 189; 64 L. R. A. 738; *Jones v. Pearl Mining Co.*, 20 Colo. 417; *Nathan v. Tompkins*, 82 Ala. 437; 2 So. 747; *Miner v. Belle Isle Ice Co.*, 93 Mich. 97, 112; 53 N. W. 218; 17 L. R. A. 412; *Wayne*

meeting, if called, could have but one result, since the wrongdoers could outvote the objectors. But, as shown above,¹ it may be necessary to summon a meeting in order to connect the majority with the wrong, where they were not originally privy to it. Thus, as more fully explained above, if a stranger has committed some wrong against the company which so cryingly calls for redress that a refusal to institute an action on behalf of the company would be in law a fraud on the part of the majority, nevertheless until a general meeting has been called and the opportunity given to the majority shareholders of authorizing the necessary proceedings to be taken in the company's name, the majority would not be demonstrated to have been guilty of any wrong. Only when such opportunity has been given and rejected do the majority become identified with the wrong; but as soon as the majority are connected with the wrong to be redressed, minority shareholders may sue without the necessity of calling a shareholders' meeting.

§ 1148. **Necessity for showing that Majority of Directors are in Complicity with misconducting Majority of Shareholders — Serving Demand on Directors to sue in Corporate Name.** — In order to maintain a suit in the name of a minority shareholder on account of a wrong committed by the majority shareholders, it must appear, according to some authorities, that the majority of the directors are at the time of suit in complicity with the misconducting majority of the shareholders;² for otherwise, it

Pike Co. v. Hammons, 129 Ind. 368; 27 N. E. 487; *Von Arnim v. American Tube Works*, 188 Mass. 515; 74 N. E. 680; *Polhemus v. Polhemus*, 114 N. Y. App. Div. 781; 100 N. Y. Supp. 263; *Memphis, etc. R. R. Co. v. Woods*, 88 Ala. 630; 7 So. 108; 7 L. R. A. 605; 16 Am. St. Rep. 81. But see *Fitchett v. Murphy*, 46 N. Y. App. Div. 181; 61 N. Y. Supp. 182.

In the federal courts, under Rule 94 (as to which see *infra*, § 1170) a demand upon the directors has been held to be necessary before a shareholder may sue in his own name, although the directors own a majority of the shares and are themselves implicated in the wrongs

complained of. *Squair v. Lookout Mountain Co.*, 42 Fed. 729. Cf. *Church v. Citizens St. R. Co.*, 78 Fed. 526. But the contrary has also, and with better reason, been held. *Harrison v. Thomas*, 112 Fed. 22; 50 C. C. A. 98; *Berwind v. Canadian Pac. Ry. Co.*, 98 Fed. 158.

¹ *Supra*, § 1145.

² *Hodgson v. Duluth, etc. R. R. Co.*, 46 Minn. 454 (headnote inadequate); 49 N. W. 197; *Mack v. DeBardleben, etc. Co.*, 90 Ala. 396; 8 So. 150; 9 L. R. A. 650; *Dunphy v. Traveller Newspaper Co.*, 146 Mass. 495; 16 N. E. 426; *Wolf v. Pennsylvania R. R. Co.*, 195 Pa. St. 91; 45 Atl. 936; *Louisville, etc. R. R.*

is argued, the directors might authorize a suit in the company's name — the regular procedure. According to this view, a minority shareholder must connect the directors with the wrongdoing majority of the shareholders; and the ordinary method of establishing such a connection is by making a demand upon the directors to bring suit in the corporate name.

Generally, however, the directors are in sympathy with the majority of the shareholders, and in that case, of course, it is not necessary for the complaining shareholder to serve a demand upon the directors.¹ Indeed, it is submitted that directors who were elected by the votes of the wrongdoing shareholders should be presumed to be controlled by the wrongdoers, so as to relieve the objecting shareholder from the necessity of demanding that the directors bring the suit.² Indeed, there would seem to be cogent reasons in favor of allowing a minority shareholder to sue where the majority of the shareholders are committing or have committed a wrong, even though the directors are not in sympathy with the misconducting majority; for even if the directors should authorize suit to be brought in the name of the company against the majority shareholders, the latter could oust the directors from office and order the abandonment of the case before it could be prosecuted to judgment.

Co. v. Neal, 29 So. 865; 128 Ala. 149; *Pass., etc. Co. v. Fisher*, 51 S. E. 198; *Virginia Pass., etc. Co. v. Fisher*, 104 Va. 121 (allegation that directors were controlled by and in collusion with the wrongdoers held to state a mere conclusion of law and to be insufficient on demurrer); *Fuller* (Pa.), 66 Atl. 754 (headnote inadequate).

Cf. *O'Connor v. Virginia Pass., etc. Co.*, 184 N. Y. 46, 52-53; 76 N. E. 1082.

¹ *Jacobson v. Brooklyn Lumber Co.*, 184 N. Y. 152; 76 N. E. 1075; *Hingston v. Montgomery* (Mo.), 97 S. W. 202.

² *Mack v. DeBardeleben, etc. Co.*, 90 Ala. 396, 400; 8 So. 150; 9 L. R. A. 650 (semble).

Cf. *Rogers v. Nashville, etc. Ry. Co.*, 91 Fed. 299; 33 C. C. A. 517; *George v. Central R. R., etc. Co.*, 101 Ala. 607, 624; 14 So. 752; *Earle v. Seattle, etc. Ry. Co.*, 56 Fed. 909; *Montgomery Traction Co. v. Harmon*, 140 Ala. 505; 37 So. 371; *Virginia*

But see contra: *Dunphy v. Traveler Newspaper Co.*, 146 Mass. 495; 16 N. E. 426; *Hodgson v. Duluth, etc. R. R. Co.*, 46 Minn. 454 (headnote inadequate); 49 N. W. 197; *Wolf v. Pennsylvania R. R. Co.*, 195 Pa. St. 91; 45 Atl. 936; *Bowne v. Smith*, 44 N. Y. Misc. 575; *Louisville, etc. R. R. Co. v. Neal*, 29 So. 865; 128 Ala. 149.

§ 1149-§ 1157. *Suits by Shareholders for Injuries to the Company in Cases where Wrongdoers do not constitute a Majority of the Shareholders.*

§ 1149. **In general.**—In one case the English Court of Appeal laid down the rule that cases where the majority have been guilty of a wrong against the company constitute the only exception to the rule requiring complaints of injuries to a corporation to be brought in the corporate name, and are the only cases in which a shareholder may sue for a wrong to the company.¹ But the rule in *Foss v. Harbottle* is not so unbending. One cannot say that only where the majority of the company commit a wrong against it do the ends of justice demand that a shareholder be permitted to sue for a violation of the company's rights. Accordingly decisions are not lacking, even in England, in which shareholders have maintained a suit, although the condition laid down in *MacDougall v. Gardiner* had not been fulfilled.² Nevertheless, in vastly the larger number of cases in which a shareholder's bill can be supported, the majority have been guilty of some wrong or default.

§ 1150. **Suits on account of Wrongs done by the Directors.**—The mere fact that the directors, who have temporary control of the company, violate its rights is not in strict law sufficient ground for judicial intervention at suit of a shareholder. The majority of the company should first be given an opportunity to decide whether the necessary steps shall not be taken in the name of the corporation; and therefore a discontented shareholder should first have a shareholders' meeting convened to which his complaints should be addressed.³ If the majority side with him, whatever is done is done in the regular way—that is, in the company's name; if the majority side against

¹ *MacDougall v. Gardiner*, 1 Ch. *Dunphy v. Traveller Newspaper Ass'n*, 146 Mass. 495, 497; 16 N. E. D. 13.

² *Pender v. Lushington*, 6 Ch. D. 426 (semble); *Bill v. Western Union Tel. Co.*, 16 Fed. 14; *Johns v. McLester*, 137 Ala. 283; 34 So. 174; 16 Eq. 298. 97 Am. St. Rep. 27; *Kavanaugh v.*

³ *Foss v. Harbottle*, 2 Hare 461; *Commonwealth Trust Co.*, 103 N. Y. *Miller v. Murray*, 17 Colo. 408; 30 App. Div. 95, affirmed in s. c., 181 Pac. 46; *Montgomery Light, etc. Co.* N. Y. 121. Cf. *Hamilton v. Desjar-v. Lahey*, 121 Ala. 131; 25 So. 1006; *dins Canal Co.*, 1 Grant (Can.) 1.

him, then on the principles stated above he may sue in his own name provided the action of the majority is in legal contemplation wrongful, — that is, if it is fraudulent or *ultra vires*, — otherwise he is without remedy.

If the regulations of the company do not afford the shareholder any means of convening a general meeting, then the action of a majority of the directors is tantamount, for present purposes, to the same action by a majority of the company, and gives the protesting shareholders the same right of suit.¹ Indeed, many American cases disregard the rule that wrongdoing on the part of a majority of the directors is not sufficient ground for the filing of a shareholder's bill to right the wrong.²

¹ *Schoening v. Schwenk*, 112 Iowa 733; 84 N. W. 916; *Tevis v. Hammersmith*, 66 N. E. 79, 912; 31 Ind. App. 281 (where complainant owned a majority of the shares but any attempt to interfere with defendants would result in the perpetration of the wrong sought to be enjoined. *Sed quære* whether the bill ought not to have been filed in the name of the corporation as plaintiff), affirmed, 67 N. E. 672; 161 Ind. 74.

² Said the court in *Brewer v. Boston Theatre*, 104 Mass. 378, 387: "Whether there must be an effort to move the corporate body to the redress of its own injuries; and, to that end, an attempt to procure a meeting and vote of the stockholders; or whether an application to the present board of officers by whom the corporate affairs are managed, and a refusal by them to allow proceedings in its name and behalf, would be sufficient, does not seem to have been determined by any clear concurrence of decision. It may depend somewhat on the character of the corporate organization and the extent of the powers confided to its officers for the time being. Where the stockholders retain no control of the corporate business except by means of an annual election of officers, those officers, during their term of office, represent the corporation for all purposes; and a refusal by them to take proper action for the protection of its interests, or to allow the use of the corporate name for that purpose, ought to be sufficient to justify a proceeding in behalf of the individual stockholders, making the corporation a party defendant."

Cf. *Foss v. Harbottle*, 2 Hare 461.

² *Smith v. Dorn*, 96 Cal. 73; 30 Pac. 1024; *Green v. Hedenberg*, 159 Ill. 489; 42 N. E. 851; 50 Am. St. Rep. 178; *Hodges v. New England Screw Co.*, 1 R. I. 312; *Pearson v. Concord R. R. Co.*, 62 N. H. 537; 13 Am. St. Rep. 590; *Cook v. Berlin Woolen Mill Co.*, 43 Wisc. 433; *Hazard v. Durant*, 11 K. I. 195; *Currier v. N. Y., etc. R. R. Co.*, 35 Hun (N. Y.) 355; *Hanna v. Lyon*, 179 N. Y. 107; 71 N. E. 778; *Appleton v. American Malting Co.*, 54 Atl. 454; 65 N. J. Eq. 375; *Glover v. Manila, etc. Milling Co.* (S. Dak.), 104 N. W. 261; *Davis v. Gemmell*, 70 Md. 356; *Torrey v. Toledo Portland Cement Co.* (Mich.), 113 N. W. 580; *Knoop v. Bohmrich*, 49 N. J. Eq. 82; 23 Atl. 118.

Cf. *Hersey v. Veazie*, 24 Me. 9, 11; 41 Am. Dec. 364; *O'Connor v. Virginia Pass., etc. Co.*, 184 N. Y. 46,

These cases assert rather plausibly that the directors are not proper parties to manage a litigation against themselves, even though the majority of the shareholders are free from any participation in the wrong.¹ Where the wrong of the directors consists in failing to sue in the name of the corporation to redress an injury done by a third person, the same considerations are applicable that have been already set out with reference to the discretionary power of the majority of the shareholders to refrain from suing to redress an injury committed by a stranger.² Ordinarily, the method of putting the directors in the wrong is by serving upon them a formal request to institute suit against the wrongdoer; but this request may be obviated by the circumstances already considered.³ An allegation that the directors are acting in the interest of and under the control of the wrongdoer and have allowed themselves to become little else than his creatures is too vague to excuse a demand upon the directors.⁴ The subject for inquiry, of course, is the status of those who are directors at the time of suit brought rather than at the time of the commission of the original wrong.⁵

§ 1151. **Suits to enjoin threatened Injury to Corporation — Necessity for Immediate Action as Excuse for failing to appeal to proper Authorities to sue in Corporate Name.** — Another exception to the rule in *Foss v. Harbottle* — recognized in America if not in England — is found in cases where a preventive remedy against a threatened wrong to the company is sought. In such cases, where there is no time to call on those in control of the corporation to take the necessary steps to prevent the threatened imminent wrong, any shareholder may throw himself into the breach and obtain an injunction. Want of time is a sufficient excuse for failing to appeal from the directors to a shareholders' meeting.⁶ For instance, if directors are about to do or suffer

¹ Doubtless the opposing line of authorities would not deny this proposition, but would reason that the remedy of the shareholders is by the election of new directors or perhaps by the appointment of special agents to manage the litigation free from any power or control of the directors.

² *Supra*, § 1145, § 1146.

³ *Supra*, § 1146, § 1147.

⁴ *Brewer v. Boston Theatre*, 104 Mass. 378.

⁵ *Brewer v. Boston Theatre*, 104 Mass. 378.

Cf. Appleton v. American Malting Co., 65 N. J. Eq. 375.

⁶ *Hawes v. Oakland*, 104 U. S. 450, 461 (semble).

See also *Greenwood v. Freight Co.*, 105 U. S. 13, 14-16 (headnote inadequate); *Great Western Ry. Co. v.*

others to do some irreparable injury to the company, a shareholder is not bound to wait until a general meeting can be convened and thus give time for the consummation of the wrong, but may file his bill at once to enjoin the directors from their threatened misdeed. It is conceived that in such a case he is not required to show that the anticipated wrong is of such a nature that not even the majority of the shareholders could lawfully condone it,¹ but that a court of equity will interfere to preserve the corporate rights until such time as the majority of the shareholders shall determine upon the course which they desire to be pursued. Indeed, in a case of great urgency, a shareholder may be allowed to file a bill to enjoin a threatened injury to the company without making a demand upon the directors, still less upon the shareholders, to institute the appropriate proceeding in the company's name.² For instance, if the injury is so imminent that for any reason the directors cannot be reached before the harm would be done, a shareholder might be allowed to file his bill at once;³ and of course if the directors are themselves the wrongdoers a demand upon them to bring suit in the name of the company is never necessary.⁴ If, however, a change has taken place in the personnel of the board of directors before

Rushout, 5 De G. & Sm. 290; *Tevis v. Hammersmith*, 31 Ind. App. 281, 286-287; 66 N. E. 79, 912. Perhaps in England the shareholder's only remedy would be a bill filed without authority in the corporate name with the hope that a majority would ratify it. See *supra*, § 1139-§ 1141. Compare, however, *Normandy v. Ind, Coope & Co.* (1908), 1 Ch. 84, 108, where Kekewich, J., said: "If the directors of a company, purporting to act on the authority of resolutions irregularly passed, were threatening to part with the property of the company in such manner as fairly to justify the charge of irreparable injury, I am not satisfied that the Court would not interfere by injunction to prevent that injury, notwithstanding the possibility, or even probability, that the company would, in general meeting, subsequently uphold the directors' conduct."

¹ *Samuel v. Holladay*, 1 Woolwich 400, 420 (semble). But see *Yetts v. Norfolk Ry. Co.*, 3 De G. & Sm. 293. Compare also last preceding note.

² *Starr v. Shepard* (Mich.), 108 N. W. 709 (where in an emergency the shareholder requested the secretary, as the chief executive officer, to institute legal proceedings).

³ Cf. *Corbus v. Alaska, etc. Gold Mining Co.*, 187 U. S. 455, 465; 23 Sup. Ct. 157 (where absence of the directors was, under the circumstances, held an insufficient excuse for failing to make a demand upon the directors).

⁴ *Loewenstein v. Diamond Soda Water, etc. Co.*, 94 N. Y. App. Div. 383; 88 N. Y. Supp. 313; *Appleton v. American Malting Co.*, 54 Atl. 454; 65 N. J. Eq. 375.

Cf. *Crow v. Florence Ice, etc. Co.*, 39 So. 401; 143 Ala. 541.

the suit is instituted, so that less than a majority of the board as then constituted had been implicated in the wrong complained of, a demand upon the board of directors is, if time permits, a prerequisite to a shareholder's bill.¹ In all these cases where a shareholder seeks to prevent a threatened injury to the company, it ought to be made clearly to appear that the injury threatened is serious if not irreparable;² and the court will be especially slow to entertain the shareholder's bill if the case is such that a court of equity would have had no jurisdiction to support a bill for an injunction in the name of the corporation as complainant.³

§ 1152. **Suits for Injuries to the Company which are also Violations of Individual Rights of certain Shareholders.** — In some cases acts which are wrongs against the company are also violations of individual rights of the several shareholders or some of them.⁴ In such cases each shareholder so injured has an individual cause of action of which he is not deprived by the Rule in *Foss v. Harbottle*.⁵ For instance, each shareholder has an individual, several right to vote at general meetings of the company and to insist that his vote be counted; and if his vote is unlawfully rejected, he may file a bill in equity to require effect to be given to it.⁶ So, under the regulations of some companies, each shareholder has a right to distribute his shares among various trustees

¹ *Siegmán v. Maloney*, 54 Atl. 405; 65 N. J. Eq. 372.

² *Ryan v. Williams*, 100 Fed. 172 (application for preliminary injunction).

³ *Corbus v. Alaska, etc. Gold Mining Co.*, 187 U. S. 455 (headnote inadequate); 23 Sup. Ct. 157.

⁴ Cf. *supra*, § 1136.

⁵ For authorities bearing on the application of this principle see, in addition to the cases cited in the succeeding notes, *infra*, § 1638.

The test of whether a shareholder's individual rights are involved in a wrong against the company would seem to be, "Is the complainant affected only as every other shareholder is affected, or is he affected in some manner peculiar to himself?" See *Converse v. United Shoe Machinery Co.*, 185 Mass. 422,

423; 70 N. E. 444; *Niles v. N. Y., etc. R. R. Co.*, 176 N. Y. 119; 68 N. E. 142; *Lawrence v. Curtis*, 191 Mass. 240 (where a beneficiary of a voting trust was held to have no individual right of action against the voting trustees for acts of mismanagement committed by them as directors of the corporation); *Wells v. Dane*, 101 Me. 67; 63 Atl. 324; *Bigelow v. Calumet, etc. Mining Co.*, 155 Fed. 869 (where the acquisition of a controlling interest in a corporation for the purpose of creating a monopoly was thought to be an individual wrong to a minority shareholder).

⁶ *Pender v. Lushington*, 6 Ch. D. 70, 80–81. Cf. *Supreme Lodge v. Simering*, 88 Md. 276, 287; 40 Atl. 723; 71 Am. St. Rep. 409; 41 L. R. A. 720.

so as to increase his voting power, and in such cases if the directors undertake to defeat this right by hastening the usual shareholders' meeting, they wrong the several shareholders thus affected, who accordingly may enjoin the proceeding¹ in spite of the rule in *Foss v. Harbottle*. Another instance of the same kind is where the directors disregard the rights of existing shareholders to a preference in the allotment of an increase of capital.² Likewise, it would seem that the rule in *Foss v. Harbottle* should not prevent preferred shareholders from asserting and defending their preferential rights. So, a shareholder who has been duly chosen director has an individual right to attend and vote at board meetings, and this individual right he may enforce by appropriate legal remedies³ without seeking redress through the corporate organization. Similarly, the rule in *Foss v. Harbottle* has no application to a bill by a shareholder to enjoin or annul an illegal forfeiture of his shares.⁴

Even in cases where the individual rights of a member of a corporation are violated by some irregularity in the management of the corporation, some authorities relating to beneficial societies and similar organizations apparently uphold the doctrine that he cannot maintain an action or suit without first exhausting his remedies within the corporation;⁵ but there are other authorities which tend in the opposite direction,⁶ and which are likely

¹ *Cannon v. Trask*, 20 Eq. 669.

² *Way v. American Grease Co.*, 60 N. J. Eq. 263; 47 Atl. 44; *Dousman v. Wisconsin, etc. Co.*, 40 Wisc. 418; *Davis v. Commercial Pub. Co.*, 1 State Rep. (N. So. Wales) Eq. 37 (held, as stated in text, although the right to preference in allotment of the new shares was conferred merely by the company's regulations, which by going through certain forms a statutory majority of the company might alter).

³ *Infra*, § 1508.

⁴ *Sweny v. Smith*, 7 Eq. 324; *Moses v. Tompkins*, 84 Ala. 613; 40 So. 763.

⁵ *Thomas v. Musical, etc. Union*, 121 N. Y. 45; 24 N. E. 24; 8 L. R. A. 175; *Poultney v. Bachman*, 31 Hun (N. Y.) 49; *Byram v. Sovereign Camp*, 108 Iowa 430, 437; 79 N. W.

144; 75 Am. St. Rep. 265; *Blumenfeldt v. Korschuck*, 43 Ill. App. 434; *Grant v. Langstaff*, 52 Ill. App. 128; *Wood v. What Cheer Lodge*, 20 R. I. 795; 38 Atl. 895; *Loeffler v. Modern Woodmen*, 100 Wisc. 79; 75 N. W. 1012; *Fillmore v. Great Camp*, 109 Mich. 13; 66 N. W. 675; *Weigand v. Fraternities Accident Order*, 97 Md. 443; 55 Atl. 530 (distinguished in *Wells & McComas Council v. Littleton*, 100 Md. 416; 60 Atl. 22).

Cf. Holomany v. National Slavonic Soc., 39 N. Y. App. Div. 573; 57 N. Y. Supp. 720; *Quentell v. N. Y. Cotton Exchange*, 106 N. Y. Supp. 228 (holding that failure to exhaust remedies within the corporation is excused where it appears that any effort to do so would have been unavailing).

⁶ *Bauer v. Samson Lodge*, 102

to be universally followed as regards members of joint-stock corporations.¹

§ 1153. **Suits to enjoin Ultra Vires Acts** — *Dodge v. Woolsey*. — Perhaps the right of the shareholder to enjoin the diversion of the corporate funds to an *ultra vires* purpose may rest upon some such principle as that stated in the preceding section.² To be sure, in many cases the shareholder may sue to enjoin a threatened *ultra vires* act, on the principles stated above;³ but it seems that where an *ultra vires* act is about to be committed, a shareholder is never bound to call upon the directors or upon the other shareholders to institute proceedings to prevent it, but may at once file his own bill for an injunction.⁴ The very basis of the contract of membership in a corporation is that its funds shall be devoted only to the purposes of its business, and any diversion of them to any other or different purpose may always be enjoined by every shareholder. Thus, where the directors refuse to take any steps to prevent the collection of a tax which is levied upon the company in violation of a contract with the state embodied in its charter and which is therefore unconstitutional and void, and which was believed by the directors themselves so to be, any shareholder may enjoin the enforcement and collection of

Ind. 262; 1 N. E. 571; *Grimbly v. Harrold*, 125 Cal. 24, 29-30; 57 Pac. 558; 73 Am. St. Rep. 19; *Roxbury Lodge v. Hocking*, 60 N. J. Law 439; 38 Atl. 693; *Grand Central Lodge v. Grogan*, 44 Ill. App. 111; *Voluntary Relief Dept. v. Spencer*, 17 Ind. App. 123, 128-129; 46 N. E. 477; *Wells & McComas Council v. Littleton*, 100 Md. 416; 60 Atl. 22.

¹ *Blumer v. Ulmer* (Miss.), 44 So. 161 (headnote inadequate — action for deceit maintainable against officers without first requesting company to sue); *Bigelow v. Calumet, etc. Mining Co.*, 155 Fed. 869.

² Cf. *Northern Trust Co. v. Snyder*, 89 N. W. 460, 462-463; 113 Wisc. 515; 90 Am. St. Rep. 867; *Dickinson v. Consolidated Traction Co.*, 114 Fed. 232, 239-240 (affirmed on other grounds in 119 Fed. 871; 56 C. C. A. 401); *Kean v. Johnson*, 9 N. J. Eq. 401.

³ *Tomkinson v. South-Eastern Ry. Co.*, 35 Ch. D. 675; *Langolf v. Seiblerlitch*, 2 Pars. Eq. Cas. (Pa.) 64. As an *ultra vires* act on the part of the majority is always wrongful and as an injunction against an *ultra vires* act is not usually needed unless the threatened act has the approval of the majority, it can readily be understood that suits to enjoin *ultra vires* acts are usually also suits to enjoin wrongful acts on the part of the majority.

⁴ *Heath v. Erie Ry. Co.*, 8 Blatchf. 347; *Dickinson v. Consolidated Traction Co.*, 114 Fed. 232, 239-240 (semble), affirmed on different grounds in 119 Fed. 871; 56 C. C. A. 401.

But see *Corbus v. Alaska, etc. Mining Co.*, 187 U. S. 455; 23 Sup. Ct. 157; *Stewart v. Washington, etc. S. S. Co.*, 187 U. S. 466; 23 Sup. Ct. 161.

the tax.¹ This case of *Dodge v. Woolsey* is the leading case in the United States upon the subject of shareholders' bills; but, while it has often been cited with approval, caution is necessary in using as authority at the present day isolated passages from the opinion of the court, which, we should remember, was delivered before this subject had been thoroughly thought out and while the law was in an embryonic condition.

Of course, in order to sustain a bill by a shareholder to enjoin *ultra vires* acts, it must appear that the *ultra vires* act sought to be enjoined is really imminent; for a court of equity never interferes by injunction upon a mere vague apprehension or in order to enable the parties to test an abstract question of right. Thus, a mere allegation that an *ultra vires* act "will be" done by the company, unaccompanied by charges of any facts tending to give credence to the averment, is insufficient, even on demurrer.²

On the other hand, if an *ultra vires* act is imminent, it is immaterial that, if consummated, the injury to the company would not be irreparable,³ or even that no damage would be sustained by the company or that the consummation of the transaction would be positively beneficial.⁴

§ 1154. *What is such an Ultra Vires Act as a Shareholder may enjoin.* — Anything done for an *ultra vires* purpose, although in itself lawful, comes within the category of acts which will be enjoined at the suit of a shareholder as *ultra vires*.⁵ Thus, the borrowing of money which is intended to be spent for some *ultra vires* object will be enjoined.⁶ So, where an agreement is made in furtherance of one main object which is *ultra vires*, the execution of any of its provisions, even those which are in themselves *intra vires*, will be enjoined, although by the terms of the agreement itself any illegality of some of its provisions is not

¹ *Dodge v. Woolsey*, 18 How. 331 (explained by Miller, J., in *Samuel v. Holladay*, 1 Woolwich 400, 418-419, and in *Huntington v. Palmer*, 104 U. S. 482, 484).

But cf. *Corbus v. Alaska, etc. Mining Co.*, 187 U. S. 455; 23 Sup. Ct. 157.

² *Hutton v. Bancroft & Sons Co.*, 83 Fed. 17. Cf. *Quin v. Havenor*, 94 N. W. 642; 118 Wisc. 53.

³ But see *Schoenfeld v. American*

Can Co. (N. J.), 55 Atl. 1044 (where the court refused a preliminary injunction against paying an unearned dividend).

⁴ Cf. *Davis v. Congregation Tephila Israel*, 40 N. Y. App. Div. 424.

⁵ *Theis v. Durr* (Wisc.), 104 N. W. 985, 125 Wisc. 651.

⁶ *Great Western Ry. Co. v. Rush-out*, 5 De G. & Sm. 290.

to prevent the execution of the others.¹ Moreover, the shareholder may veto the expenditure of any of the company's funds, not merely its capital, but also its accumulated profits, for an *ultra vires* purpose; although of course if the profits have been distributed as dividends they belong to the several shareholders, so that then each shareholder may devote his own proportion to any object he may see fit.² On the other hand, it is said that where a duty is imposed upon a company wholly for the benefit of the public and not at all for that of the shareholders, an individual member of the corporation has no right to an injunction against its violation;³ but this principle (even if its soundness be conceded) is necessarily of a very limited application.

§ 1155. **Suits to undo executed Ultra Vires Transactions.** — It is a different question whether, when some *ultra vires* transaction has been executed, a court of equity will intervene at the suit of a shareholder to rip it open and undo it. Thus, in a comparatively early case the Rhode Island Supreme Court held that where a corporation had made an *ultra vires* purchase of shares in another company, a court of equity would not at the instance of a shareholder in the first company order that the shares so purchased should be sold and the *ultra vires* relationship terminated.⁴ In the same way, where an *ultra vires* contract has been

¹ *Hattersley v. Earl of Shelburne*, 31 L. J. Ch. 873. Cf. *Wall v. London & Northern Assets Corporation* (1898), 2 Ch. 469; *Great Western Ry. Co. v. Birmingham, etc. Ry. Co.*, 2 Phill. 597.

² *Salomons v. Laing*, 12 Beav. 339, 352.

³ *Browne v. Monmouthshire Ry. Co.*, 13 Beav. 32. Cf. *Harding v. American Glucose Co.*, 182 Ill. 551, 625-626; 55 N. E. 577; 74 Am. St. Rep. 189; 64 L. R. A. 738; *George N. Fletcher & Sons Co. v. Alpena Circuit Judge*, 99 N. W. 748; 136 Mich. 511 (holding that a shareholder cannot always enjoin the company from making a usurious contract); *Anderson v. Midland Ry. Co.* (1902), 1 Ch. 369 (holding that shareholder in railway company cannot enjoin the corporation from violating a statute forbidding dis-

crimination between shippers in respect to rates).

But see *Manderson v. Commercial Bank*, 28 Pa. St. 379.

⁴ *Hodges v. New England Screw Co.*, 1 R. I. 312; 3 R. I. 9.

Cf. *Hutton v. Bancroft & Sons Co.*, 83 Fed. 17 (headnote inadequate); *Metcalfe v. American School Furniture Co.*, 122 Fed. 115; *Rogers v. Nashville, etc. Ry. Co.*, 91 Fed. 299, 317 (headnote inadequate); 33 C. C. A. 517; *Smith v. Bulkley* (Colo.), 70 Pac. 958; 18 Colo. App. 227; *Northern Trust Co. v. Snyder*, 89 N. W. 460; 113 Wis. 516; 90 Am. St. Rep. 867; *Dickinson v. Consolidated Traction Co.*, 114 Fed. 232, 239-240 (affirmed on other grounds in s. c., 119 Fed. 871; 56 C. C. A. 401); *Towers v. African Tug Co.* (1904), 1 Ch. 558 (suit to recover dividends paid out of capital);

fully executed by the other party and is according to the *lex fori* enforceable against the company, a minority shareholder cannot enjoin the corporation from performing the contract on its side.¹

§ 1156. **Suits relating to Irregularities in Conduct of Shareholders' Meetings.**—Another and real exception to the rule that the corporation is the only proper party to complain of irregularities in its management is found in cases where the irregularities relate to the conduct of shareholders' meetings. The theory of the rule in *Foss v. Harbottle* is that the majority of the company in general meeting should be permitted to decide whether the corporation should seek a remedy for irregularities of which its managers are alleged to have been guilty; but if those very managers shape the proceedings at shareholders' meetings according to their will, and by illegal manipulation of such meetings prevent any complaint being made against their previous misdoing, the reason for the rule ceases. In such cases, the shareholder must be allowed to sue for that redress to which the company is entitled and which it is wrongfully prevented from obtaining; for otherwise the wrong would go without remedy, unless indeed by the perilous course of a suit in the name of the company without previous authority, in the hope that the action so taken might be ratified by the company. Hence, the ends of justice require that the shareholder be

Terry v. Eagle Lock Co., 47 Conn. 141; *Buford v. Keokuk Northern Line Packet Co.*, 69 Mo. 611 (holding that a shareholder in a corporation which has issued shares in exchange for property cannot deny the validity of the stock so long as the company retains the property); *Gray v. Chaplin*, 2 Russ. 126.

But see *Kessler v. Ensley Co.*, 123 Fed. 546, 559–560; *Siegmán v. Electric Vehicle Co.*, 140 Fed. 117; *Siegmán v. Electric Vehicle Co.* (N. J.), 65 Atl. 910; *City of Chicago v. Cameron*, 120 Ill. 447; 11 N. E. 899 (suit to cancel bonds issued *ultra vires* before they should come to the hands of innocent purchasers); *Morris v. Elyton Land Co.*, 125 Ala. 263; 28 So. 513 (“A court of chancery can and will undo an act which is *ultra vires* as well as prevent the

same by injunction”); *Memphis, etc. R. R. Co. v. Grayson*, 88 Ala. 572; 7 So. 122; 16 Am. St. Rep. 69 (as to setting aside *ultra vires* railway lease).

In *Sweny v. Smith*, 7 Eq. 324, it was said that the rule in *Foss v. Harbottle* has no application to a suit by a shareholder to set aside a contract alleged to be *ultra vires*. The contract doubtless remained still executory.

¹ *Rankin v. Southwestern Brewery, etc. Co.* (N. Mex.), 73 Pac. 612.

Cf. *Wisconsin Lumber Co. v. Greene, etc. Tel. Co.* (Iowa), 101 N. W. 742 (where it was said that a shareholder cannot set aside an *ultra vires* transaction which the corporation could not repudiate, unless the injury is substantial).

allowed to sue, and according to established principles such must be the result.¹

Nevertheless in one case, *MacDougall v. Gardiner*,² a case which has been questioned for the narrowness of the views which the judgment expresses, a contrary conclusion was reached. There, a resolution for the removal of a director having been offered, the director's friends, to prevent its passage, moved that the meeting adjourn. The chairman having declared this motion carried, those opposed to adjournment demanded a poll; but the chairman ruled that a poll could not be had on a motion to adjourn, and accordingly declared the meeting adjourned. The opposition party, however, remained in the room, and purported to pass the resolution removing the obnoxious director. The proposer of this latter resolution filed a bill on behalf of himself and the other shareholders against the directors and the company, praying a declaration that the refusal to grant a poll on the question of adjournment was illegal, and that a meeting might be summoned to which plaintiff's resolution might be submitted. This bill was held bad on demurrer, on the ground that all the acts complained of were (if wrongs at all) wrongs to the company, and that therefore the company alone was a proper party plaintiff. The court proceeded upon the proposition, which has been doubted above, that a shareholder may sue instead of the corporation only when the wrongdoers compose the majority of the company. "Hence," they said in substance, "as this is not the case here, the bill is bad; and it makes no difference that the question in dispute relates to the proper manner of conducting shareholders' meetings."³ It was

¹ Said Kekewich, J., in *Tiessen v. Henderson* (1899), 1 Ch. 861, 866: "The application of the doctrine of

Foss v. Harbottle to joint-stock companies involves as a necessary corollary the proposition that the vote of the majority at a general meeting, as it binds both dissentient and absent shareholders, must be a vote given with the utmost fairness—that not only must the matter be fairly put before the meeting, but the meeting itself must be conducted in the fairest possible manner." See, however, *Normandy v. Ind, Coope*

& Co. (1908), 1 Ch. 84, 106–109, a later decision of the same learned judge.

² 1 Ch. D. 13.

³ James, L. J., said: "I cannot conceive that there is any equity on the part of a shareholder, on behalf of himself and the minority, to say: 'True it is that the majority have a right to determine everything connected with the management of the company, but then we have a right—and every individual has a right—to have a meeting held in strict accordance with the articles.' Has

suggested that the plaintiff ought to have filed the bill in the company's name, and that then the court would have ordered proceedings to take the sense of the shareholders on the question whether the suit should be allowed to continue in the company's name, and that thus the desired relief might have been obtained.¹ But to compel a shareholder in such a position to pursue the hazardous and really unwarranted course of entering suit in the company's name without authority seems a denial of justice.

Accordingly, although *MacDougall v. Gardiner* has been often cited without disapproval on both sides of the Atlantic, yet both in the United Kingdom and in the United States shareholders have been allowed to sue, notwithstanding the rule in *Foss v. Harbottle*, where the time or manner of holding shareholders' meetings is in question.² So, a shareholder may enjoin directors from perpetuating their own control of the company by postponing the annual meeting for the election of their successors.³ In some of these cases, indeed, the shareholder's right to sue might be supported because of violation of some individual right of the shareholder — such as a wrongful rejection of his vote. But it seems clear that he should have the same right of intervention in other cases — for example, where the officers of the company received *his* vote but wrongfully rejected the votes of

a particular individual the right to have it for the purpose of using his powers of eloquence to induce the others to listen to him and to take his view? That is an equity I have never yet heard of in this Court." 1 Ch. D. 23.

¹ James, L. J., said, "Any one of the shareholders might have filed his bill in the name of the company, and then if the directors had said, 'You are not the company; the majority do not act with you, but with us,' the court would, as it has done in other cases, have taken the means of ascertaining which party it is, the Plaintiff's or Defendant's, which really represents the majority of the company." 1 Ch. D. 22.

² *Henderson v. Bank of Australia*

lasia, 45 Ch. D. 330; *Cannon v. Trask*, 20 Eq. 669; *Jackson v. Munster Bank*, 13 L. R. Ir. 118; *Campbell v. Poultney*, 6 G. & J. (Md.) 94; 26 Am. Dec. 559; *Walker v. Johnson*, 17 App. D. C. 144, 166-169; *Villamil v. Hirsch*, 143 Fed. 654; *Dunbar v. Am. Tel., etc. Co.*, 79 N. E. 423, 428-430; 224 Ill. 9 (shareholder allowed to maintain a bill to enjoin another corporation from assuming in excess of its powers the right to purchase and vote shares in the complainant's company); *Davidson v. Grange*, 4 Grant (Can.) 377.

But see contra, *Normandy v. Ind. Coope & Co.* (1908), 1 Ch. 84.

³ *Elkins v. Camden, etc. R. R. Co.*, 36 N. J. Eq. 467.

other members. Accordingly, a shareholder has a standing in court to test the regularity of an election of directors, although not himself a candidate for the position, and although his own vote was received and counted.¹ In such cases, if the shareholder in question is to be allowed to sue, as it is submitted he should and would be, his right so to do cannot be supported because of any violation of his individual rights, but must proceed on the ground that an exception to the rule in *Foss v. Harbottle* exists where the complaint relates to the conduct of a shareholders' meeting. Thus, a shareholder has been granted the writ of mandamus to compel the directors to hold a shareholders' meeting.²

§ 1157. **Suits by Shareholders when Corporation has been enjoined from suing.**—The fact that the company has been enjoined by a court of equity from instituting suit in the corporate name is no ground for allowing a shareholder to sue in his own name.³ Indeed, the filing of a shareholder's bill under such circumstances might well be thought a violation of the injunction, and a contempt of court.⁴

§ 1158. **What is a sufficient Demand to bring Suit in Corporate Name where such a Demand is requisite.**—We have seen above that in a number of cases the right of a shareholder to file a bill based upon some violation of the rights of the corporation will depend upon whether or not he has made a demand upon the directors, or the shareholders, to bring suit for redress in the corporate name. The question, therefore, arises, What amounts to a sufficient demand for this purpose?⁵ A demand made some

¹ *Re St. Lawrence Steamboat Co.*, 44 N. J. Law 529. Cf. *Villamil v. Hirsch*, 138 Fed. 690.

² *Mottu v. Primrose*, 23 Md. 482.

³ *Smith v. Bulkley*, 70 Pac. 958; 18 Colo. App. 227.

⁴ *Smith v. Bulkley*, 70 Pac. 958; 18 Colo. App. 227.

⁵ Cf. *Ball v. Rutland R. R. Co.*, 93 Fed. 513; *Hazard v. Durant*, 11 R. I. 195 (an extreme case); *Blair v. Telegram Newspaper Co.*, 172

Mass. 201, 204; 51 N. E. 1080 (very liberal in reading into a bill a sufficient allegation of a demand); *Memphis, etc. R. R. Co. v. Woods*, 88 Ala. 630, 647; 7 So. 108; 7 L. R. A. 605; 16 Am. St. Rep. 81 (as to sufficiency of allegation of demand and refusal in general terms); *Vogeler v. Punch* (Mo.), 103 S. W. 1001, 1006 (allegation that plaintiff "has endeavored unsuccessfully by application to the company to secure relief

years before by another shareholder with whom the plaintiff was not in privity in any way will not avail the plaintiff.¹ A mere offer to conduct litigation in the name of the company and to bear the expense is not equivalent to a demand to bring suit.² A demand that suit be brought in a court which would not have jurisdiction of the controversy is clearly insufficient.³ Moreover, it has been held that a mere naked request to institute appropriate proceedings without stating the facts on which the request is based is insufficient.⁴ On the other hand, a demand that suit be brought is enough without specially demanding performance of necessary conditions precedent such as an offer to return the consideration received under a fraudulent contract of which rescission is sought.⁵

§ 1159. **What amounts to a Refusal to comply with such a Demand.** — Where a sufficient demand is alleged or proved, a failure to comply therewith within a reasonable time may be equivalent to a positive refusal of compliance.⁶ A compliance with the demand by instituting the suit cannot be treated as equivalent to a refusal, on the ground that the compliance was colorable merely.⁷

§ 1160. **Confusion in cases on Right of Shareholder to sue for Injury to Corporation.** — While the principles above set forth with reference to the circumstances under which a shareholder will be permitted to sue on account of irregularities in corporate management or other wrongs to the company seem to be sound and are believed to be supported by the general trend of the cases both in England and the United States, yet one

and protection from the wrongs and against the danger mentioned in the petition" held insufficient, being mere conclusion of law).

As to service of the "demand" upon the secretary under a statute providing that service of an original notice may be made on any officer, see *The Telegraph v. Lee*, 98 N. W. 364; 125 Iowa 17.

¹ *Dannmyer v. Coleman*, 11 Fed. 97.

² *Warren v. Para Rubber Shoe Co.*, 166 Mass. 97, 107; 44 N. E. 112.

³ *Kemmerer v. Haggerty*, 139 Fed. 693.

⁴ *Doherty v. Mercantile Trust Co.*, 184 Mass. 590; 69 N. E. 335.

Cf. *Edwards v. Mercantile Trust Co.*, 124 Fed. 381, 391 (holding that it is not necessary for the demand to state the particular allegations upon which relief is sought).

⁵ *Edwards v. Mercantile Trust Co.*, 124 Fed. 381, 391 (headnote inadequate).

⁶ *Kavanaugh v. Commonwealth Trust Co.*, 103 N. Y. App. Div. 95 (semble); 92 N. Y. Supp. 543; affirmed, 181 N. Y. 121; 73 N. E. 562.

⁷ *Gray v. South & North R. R. Co.* (Ala.), 43 So. 859.

must not expect to find in the judgments of the judges precisely the same analysis as is given in the text. The courts have often acted by instinct, rather than consciously on principle. Generally the result reached has been that demanded by the rules to be deduced from the more carefully reasoned decisions. Sometimes cases are found which can with difficulty be supported on any recognized principle; and the whole subject is involved in some uncertainty, and obscured by a vagueness which appears inevitable when the underlying principle is considered — that a shareholder's bill can be maintained wherever "the claims of justice" demand.¹

§ 1161. **Appointment of Receiver on Shareholder's Bill.** — Where the preliminary difficulty as to the standing in court of a mere shareholder as plaintiff has been surmounted, a further difficulty is encountered where part of the relief asked is the appointment of a receiver. For the objection then must be met that since a receivership takes the company out of the hands of those to whom its management is intrusted by law and by the constitution of the corporation, a receiver cannot be appointed without affirmative statutory authority. The serious consequences attendant upon any corporate receivership ought undoubtedly to cause the court to endeavor by all possible means to avoid that form of relief.² Thus, a receiver will not be appointed to prosecute actions on behalf of the company in cases in which the complaining shareholder might properly obtain redress without the intervention of a receiver, even though a

¹ *Supra*, § 1142.

² See *Langolf v. Seiberlitch*, 2 Pars. Eq. Cas. (Pa.) 64, 79; *Stevens v. Davison*, 18 Gratt. (Va.) 819; 98 Am. Dec. 692; *Overton v. Memphis, etc. R. R. Co.*, 10 Fed. 866; *Belmont v. Erie Ry. Co.*, 52 Barb. (N. Y.) 637; *Devine v. Frankford Steel, etc. Co.*, 205 Pa. St. 114; 54 Atl. 578; *Fallon v. United States Directory Co.*, 86 N. Y. App. Div. 29; 83 N. Y. Supp. 359; *Alabama Coal, etc. Co. v. Shackelford*, 137 Ala. 224; 34 So. Rep. 833; 97 Am. St. Rep. 23; *Continental Nat. Bldg., etc. Ass'n v. Miller* (Fla.), 33 So. 404; 44 Fla. 757; *New Albany Waterworks v. Louisville Banking Co.*, 122 Fed.

776; *Cincinnati, etc. R. R. Co. v. Duckworth*, 1 Oh. Circ. Dec. 618; *Donald v. Manufacturers' Export Co.* (Ala.), 38 So. 841; 142 Ala. 578; *Müller v. Kitchen* (Nebr.), 103 N. W. 297; *Taylor v. Decatur Mineral, etc. Co.*, 112 Fed. 449; *Clark v. National Linseed Oil Co.*, 105 Fed. 787; 45 C. C. A. 53; *Hutchinson v. American Palace Car Co.*, 104 Fed. 182; *Griffing v. Griffing Iron Co.*, 96 Fed. 577; *Edwards v. Bay State Gas Co.*, 91 Fed. 942; *People's Inv. Co. v. Crawford* (Tex.), 45 S. W. 738; *United Electric Securities Co. v. Louisiana Electric Light Co.*, 68 Fed. 673. See also *supra*, § 561.

receiver, being in possession of the books and records of the company, would be in a better position than a minority shareholder to maintain the actions.¹ Moreover, of course a court has no jurisdiction to appoint a receiver to wind up a corporation² except in cases where by statute a decree for its dissolution might properly be passed. But the argument which is advanced in some decisions, that *any* corporate receivership is tantamount to a dissolution and can only be had where dissolution might be granted,³ is fallacious.

Accordingly wherever, on the principles stated above, a shareholder may intervene in the corporate management, a receiver may be appointed temporarily until the affairs of the company can be so adjusted that its own officers may resume management, wherever that drastic form of relief is necessary to prevent injury to the parties in interest.⁴ Thus, where the directors are at hopeless odds, one party bolting the doors of the company's offices against the other, the court on the application of a shareholder will appoint a receiver to take charge of the company's business temporarily until the shareholders can meet and elect a more harmonious board.⁵ So, if the directors

¹ *Hallenborg v. Corre Grande Copper Co.* (Ariz.), 74 Pac. 1052.

² *Neall v. Hill*, 16 Cal. 145; 76 Am. Dec. 508; *Cincinnati, etc. R. R. Co. v. Duckworth*, 1 Oh. Circ. Dec. 618; *People's Inv. Co. v. Crawford* (Tex.), 45 S. W. 738.

³ *Mason v. Equitable League*, 77 Md. 483; 27 Atl. 171; 39 Am. St. Rep. 433; *Port Huron, etc. Ry. Co. v. Judge*, 31 Mich. 456.

⁴ *Dupuy v. Terminal Co.*, 82 Md. 408; 33 Atl. 889; 34 Atl. 910; *Haywood v. Lincoln Lumber Co.*, 64 Wis. 639; 26 N. W. 184; *Stevens v. Davison*, 18 Gratt. (Va.) 819; 20 Am. Dec. 692; *Chandler Mtge. Co. v. Loring*, 113 Ill. App. 423; *Columbia Nat. Sand Dredging Co.*, 136 Fed. 710; *Cincinnati, etc. R. R. Co. v. Duckworth*, 1 Oh. Circ. Dec. 618; *Ford v. Kansas City, etc. Ry. Co.*, 52 Mo. App. 439; *Powers v. Blue Grass Bldg., etc. Ass'n*, 86 Fed. 705.

See also *State v. Port Royal, etc.*

Ry. Co., 45 S. Car. 470; 23 S. E. 383; *Earle v. Seattle, etc. Ry. Co.*, 56 Fed. 909; and cases cited *infra*.

⁵ *Featherstone v. Cooke*, 16 Eq. 298 (approved in *Archer v. American Water Works Co.*, 50 N. J. Eq. 33, 52; 24 Atl. 508); *Sternberg v. Wolf*, 39 Atl. 397; 56 N. J. Eq. 389; 67 Am. St. Rep. 494; 39 L. R. A. 762. Cf. *Edison v. Edison United Phonograph Co.*, 52 N. J. Eq. 620; 29 Atl. 195; *Sheridan Brick Works v. Marion Trust Co.*, 157 Ind. 292; 61 N. E. 666; 87 Am. St. Rep. 207 (where a majority of the shareholders were unable to agree upon the selection of a president); *D. A. Tompkins Co. v. Catawba Mills*, 82 Fed. 780 ("deep-seated division, not to be healed" among the directors); *Jasper Land Co. v. Wallis* (Ala.), 26 So. 659; 123 Ala. 652 (receiver appointed because there were two sets of men, each claiming to be the directors).

are fraudulently endeavoring to wreck the company, a court of equity has ample power to grant the only effective relief, namely, the appointment of a receiver to take charge of the company's business until honest officers be elected,¹ more especially in a case where a forfeiture of valuable property owned by the company is imminent.² So, too, where the directors have made an unjustifiable assignment of the corporate property for the benefit of creditors, and the shareholders have unwarrantably assumed to remove them and elect a new board in their stead, a court of equity rather than return the property to the old directors, who have practically abdicated their functions, will place it in the control of a receiver.³ Moreover, where the directors were disqualified by interest from acting in an important matter, a court of equity has appointed a provisional "trustee" to manage that matter on behalf of the company.⁴ The appointment of a receiver, however, will not be accompanied by an injunction restraining the directors from acting, where that course is not indispensable to the carrying out of the objects of the appointment.⁵

This head of equitable jurisdiction must be kept distinct not only from the power to appoint a receiver as an official liquidator to wind up and dissolve a corporation, which is purely statutory, but also from the power to appoint a receiver on application of a mortgagee, or grantee under a deed of trust to secure bonds or debentures, which latter power is the ordinary power of a court of equity in any suit for foreclosure or similar relief, the

¹ *Davis v. U. S. Electric, etc. Co.*, 77 Md. 35; 25 Atl. 982; *Cantwell v. Columbia Lead Co.* (Mo.), 97 S. W. 167; *Hall v. Nieuirk* (Idaho), 85 Pac. 485 (depending in part upon an Idaho statute).

Cf. *Hayes v. Jasper Land Co.* (Ala.), 41 So. 909 (receiver refused on the ground that the directors being solvent, the remedy against them for damages would be adequate).

² *Glover v. Manila, etc. Milling Co.* (S. Dak.), 104 N. W. 261.

³ *Powers v. Blue Grass Bldg., etc. Ass'n*, 86 Fed. 705, 707.

Cf. *Stevens v. Davison*, 18 Gratt.

(Va.) 819; 98 Am. Dec. 692 (where receivers were appointed for a railway company whose directors had executed a wrongful lease of the company's road); *Morris v. Elyton Land Co.*, 125 Ala. 263; 28 So. 513 (receiver appointed for a corporation which had made an *ultra vires* transfer of its assets to another company in exchange for shares to be distributed among the shareholders of the first company).

⁴ *Pearson v. Concord R. R. Co.*, 62 N. H. 537, 550-551; 13 Am. St. Rep. 590.

⁵ *Stevens v. Davison*, 18 Gratt. (Va.) 819; 98 Am. Dec. 692.

circumstance that *all* the property of the corporation is covered being immaterial.

§ 1162. **Shareholders' Bills filed after Appointment of Receiver.** — A shareholder's bill cannot be filed after a receiver or liquidator has been appointed for the winding-up of the company ¹ — at least, not unless the receiver has refused to bring the appropriate proceedings in the name or right of the corporation.² The same rule applies to bankruptcy or insolvency proceedings, a shareholder having been allowed to sue where the assignee in insolvency has refused to do so.³ The corporation is the proper party to represent its own interests in the receivership case; and hence a shareholder will not be permitted to file, for example, a petition for the discharge of the receiver, unless such facts be shown as would justify a shareholder's bill if the company were not in the hands of a receiver.⁴

§ 1163. **Shareholders' Bills filed after Dissolution of Corporation.** — Where the corporate existence has been terminated by efflux of time, legislative repeal of the charter, or otherwise, the shareholders generally become quasi tenants in common of the company's property. Hence, the principles applicable to shareholders' bills are no longer pertinent; and the Rule in *Foss v. Harbottle* no longer applies.⁵ Sometimes, however, statutes provide that notwithstanding the corporate existence may for most purposes have terminated, yet the corporation shall continue in being for the purpose of suing and being sued. Under such statutes, even after legislative annulment of the company's

¹ *Cunningham v. Wechselberg*, 105 Wis. 359; 81 N. W. 414; *Porter v. Sabin*, 149 U. S. 473; 13 Sup. Ct. 1008; *Walter v. F. E. McAlister Co.*, 21 N. Y. Misc. 747; 48 N. Y. Supp. 26.

Cf. *Lang v. Louisiana Tanning Co.*, 56 Fed. 675; *George v. Central R. R., etc. Co.*, 101 Ala. 607, 623; 14 So. 752.

But see *Barry v. Moeller*, 59 Atl. (N. J.) 97; *Guaranty Trust Co. v. North Chicago, etc. Co.*, 130 Fed. 801; 65 C. C. A. 65.

² Cf. *Union Nat. Bank v. Hill*, 148 Mo. 380; 49 S. W. 1012; 71 Am. St. Rep. 615; *Flynn v. Third Nat. Bank*, 122 Mich. 642; 81 N. W. 572;

Ackerman v. Halsey, 37 N. J. Eq. 356; *Lafayette Co. v. Neely*, 21 Fed. 738; *Porter v. Sabin*, 149 U. S. 473; 13 Sup. Ct. 1008; *Coble v. Beall*, 130 N. Car. 533; 41 S. E. 793.

As to the necessity of making the receiver or liquidator a party to such a suit, see *Porter v. Sabin*, 36 Fed. 475.

³ *Streight v. Junk*, 59 Fed. 321; 8 C. C. A. 137.

Cf. *Meyer v. Page*, 112 N. Y. App. Div. 625.

⁴ *Fifth Nat. Bank v. Pittsburgh, etc. R. R. Co.*, 1 Fed. 190.

⁵ *Lafayette Co. v. Neely*, 21 Fed. 738.

existence, a shareholder cannot sue to protect the rights of the company except in the circumstances under which he might have done so while the company was an active corporation, demand upon the directors to sue, and so on, being necessary.¹

§ 1164-§ 1182. PLEADING AND PRACTICE IN SHAREHOLDERS' SUITS.

§ 1164-§ 1173. *The Parties Plaintiff.*

§ 1164. **In general — Necessity that Plaintiff be a Shareholder.** — The next subject demanding attention is the proper structure of shareholders' suits, particularly with regard to parties, in those cases in which according to the principles stated above such suits are maintainable.

From the very name of such suits, it is apparent that the plaintiff must be a shareholder;² it is not enough to be a creditor,³ or rival company,⁴ or other interested party whatsoever. And

¹ *General Electric Co. v. West Asheville Imp. Co.*, 73 Fed. 386.

² As to the necessity of a clear allegation in the bill that plaintiff is a shareholder, see *Bostock v. Edgar*, 24 Viet. L. R. 677.

³ *Mills v. Northern Ry. of Buenos Ayres Co.*, 5 Ch. 621, 628; *Arnold v. Searing* (N. J.), 67 Atl. 831 (stated infra, 972, n. 1, as to a bill filed on behalf of both bondholders and shareholders).

But see *Newby v. Oregon Central Ry. Co.*, Deady 609, 1 Sawy. 63; *Currier v. N. Y., etc. R. R. Co.*, 35 N. Y. 355, 360. As to suits by bondholders, see further infra, § 1928. In Wisconsin a statute gives a creditor in some cases the same right as a shareholder. *Land, Log & Lumber Co. v. McIntyre*, 100 Wisc. 245, 256; 75 N. W. 964; *Gores v. Day*, 99 Wisc. 276; 74 N. W. 787; *South Bend Chilled Plow Co. v. George C. Cribb Co.*, 97 Wisc. 230; 72 N. W. 749.

⁴ Cf. *Pudsey Coal Gas Co. v. Corporation of Bradford*, 15 Eq. 167; *Burns v. St. Paul City Ry. Co.* (Minn.), 112 N. W. 412 (bill by newspaper proprietor to enjoin street railway company from competing with plaintiff's business by publishing advertisements, on the ground that so to do was *ultra vires*, not sustainable); *Railroad Co. v. Ellerman*, 105 U. S. 166, 173-174 (wharfinger not entitled to restrain a corporation from exceeding its powers by competing with him).

Note the distinction where the excess of the corporate powers amounts to an injury to private rights. See *City of Madison v. Madison Gas, etc. Co.* (Wisc.), 108 N. W. 65. In such cases the question of *ultra vires* can be raised by a stranger only because upon it depends the question whether the legislature has legalized what would otherwise be a trespass or nuisance.

he must be a shareholder at the time of bringing suit.¹ A person claiming under a forged transfer of shares is not really a shareholder, and therefore cannot maintain a shareholder's bill;² but a person whose purchase of the shares in respect of which he is suing is attacked for fraud and who pending a suit for rescission of the purchase has been enjoined from selling, incumbering, or voting on the shares may without violating the injunction maintain a shareholder's bill.³

It is not, however, always necessary that the plaintiff be a registered shareholder,⁴ and accordingly a person claiming under an unrecorded transfer has been held to be a competent plaintiff.⁵ Thus, a *cestui que trust* of shares may sue, making his trustees co-defendants.⁶ So, a shareholder in a company

¹ *Fitchett v. Murphy*, 46 N. Y. App. Div. 181; 61 N. Y. Supp. 182; *Hanna v. Lyon*, 179 N. Y. 107; 71 N. E. 778; *Zinn v. Baxter*, 65 Oh. St. 341; 62 N. E. 327; *Dissette v. Lawrence Pub. Co.*, 9 Oh. Circ. Ct. Rep., n. s., 118; *Bostock v. Edgar*, 24 Vict. L. R. 677 (where plaintiff's membership had been suspended when the bill was filed); *MacVeagh v. Denver City Waterworks Co.*, 107 Fed. 17; 46 C. C. A. 118 (a person who had transferred all his interest in certain shares held not a competent plaintiff).

Cf. *Mayer v. Denver, etc. R. Co.*, 38 Fed. 197; *Dudley v. Armenia Ins. Co.*, 115 N. Y. App. Div. 380; *Jones v. Missouri Edison El. Co.*, 144 Fed. 765, 776-777; 75 C. C. A. 631 (holding that a fraudulent consolidation of two corporations consummated with all the forms of law may be set aside at the suit of a shareholder in one of the constituent companies, although in consequence of the consolidation shares in the constituent companies have ceased to exist).

² *Hare v. London, etc. Ry. Co.*, Johns. 722.

³ *Maine Products Co. v. Alexander*, 115 N. Y. App. Div. 475. Cf. *Hingston v. Montgomery (Mo.)*, 97 S. W. 202 (holding that decree in favor of plaintiff in suit to establish

her right as a shareholder is no bar to a shareholder's bill subsequently filed by her, although the matters involved in the second suit were alleged in the first).

⁴ But see *Hodge v. United States Steel Corp.*, 64 N. J. Eq. 90, 92; 53 Atl. 601, to be compared with s. c. in Court of Errors, 64 N. J. Eq. 807; 54 Atl. 1; 60 L. R. A. 742.

⁵ *Scanlan v. Snow*, 2 D. C. App. 137; *Parrott v. Byers*, 40 Cal. 614; *O'Connor v. International Silver Co.*, 59 Atl. (N. J.) 321, affirmed in 62 Atl. 408; *Carson v. Iowa City Gas-light Co.*, 80 Iowa 638; 45 N. W. 1068 (where the company had wrongfully refused to register the transfer).

But see query in *Mills v. Northern Ry. of Buenos Ayres Co.*, 5 Ch. 621, and *Brown v. Duluth, etc. Ry. Co.*, 53 Fed. 889, 894.

Cf. *Heath v. Erie Ry. Co.*, 8 Blatchf. 347.

A fortiori, a shareholder is not disentitled from suing merely because no certificate has been issued to him. *Spackman v. Lattimore*, 3 Giff. 16.

⁶ *Great Western Ry. Co. v. Rushout*, 5 De G. & Sm. 290; *Weber v. Wallenstein*, 111 N. Y. App. Div. 693; 97 N. Y. Supp. 846 (where plaintiff had been induced by fraud

which is *cestui que trust* of shares in another corporation and whose directors fraudulently refuse to file a shareholder's bill against the directors of the other company for mismanagement may file a bill against the two companies and their directors, and in that one suit the whole matter may be threshed out.¹ So, in some cases a pledgee of shares may sue.² In all such cases the right of the pledgee or *cestui que trust* is derived through the holder of the legal title, so that the suit can be maintained only when the pledgor or trustee might have sued.³ This principle seems to have been ignored in a Minnesota case. There the court declared that although no case was made out to entitle a shareholder to sue, since he would have a remedy at a general meeting of the company, yet a mere pledgee of shares might sue because he would not be entitled to vote at a shareholders' meeting.⁴ This curious result could be reached only by disregarding the principle that a pledgee's rights can never rise higher than those of his pledgor.

A person to whom the corporation has contracted to issue shares is, it seems, a competent plaintiff.⁵

It has been held that a shareholder's bill cannot be maintained by the holder of the bare legal title — e. g., by a vendor of shares after delivery and endorsement of the certificate but before the registration of the transfer,⁶ but this decision seems inconsistent

to transfer his shares to the trustee). Cf. *McHenry v. New York, etc. R. R. Co.*, 22 Fed. 130 (headnote inadequate).

¹ *Ryan v. Leavenworth, etc. Ry. Co.*, 21 Kans. 365. Cf. *Carson v. Iowa City Gaslight Co.*, 80 Iowa 638; 45 N. W. 1068; *Sabre v. United Traction, etc. Co.*, 156 Fed. 79 (stated infra, § 1176).

² *Green v. Hedenberg*, 159 Ill. 489; 42 N. E. 851; 50 Am. St. Rep. 178; *Gorman-Wright Co. v. Wright*, 134 Fed. 363; 67 C. C. A. 345; *Chaffee v. Quidneck Co.*, 14 R. I. 75.

³ *Dillaway v. Boston Gaslight Co.*, 51 N. E. 359; 174 Mass. 80; *City of Spokane v. Amsterdamsch Trustees Kantoor*, 60 Pac. 141 (headnote misleading); 22 Wash. 172.

⁴ *Baldwin v. Canfield*, 26 Minn.

43, 60; 1 N. W. 261, followed in *Andrews Co. v. Nat. Bank of Columbus (Ga.)*, 58 S. E. 633, 636.

⁵ Cf. *Mulvihill v. Vicksburg Ry., etc. Co.*, 40 So. 647 (when the transaction complained of would seem to have been an individual injury to the plaintiff as well as an injury to the corporation); *Bagshaw v. Eastern Union Ry. Co.*, 7 Hare 114 (holder of scrip convertible into shares), affirmed, 2 Mac. & G. 389.

⁶ *Scanlan v. Snow*, 2 App. D. C. 137, 148.

Cf. *Hoopes v. Basic Co. (N. J.)*, 61 Atl. 979 (mere nominal shareholder in whose name shares are registered merely to qualify him as director not competent to institute a statutory proceeding for a receiver).

with the established principles of equity with reference to the power of all trustees, even bare trustees, to sue for injuries to the trust property.

A shareholder is not deprived of the right to sue because the shares were issued to him as fully paid upon payment of less than the par value.¹

Of course, two or more shareholders may join in the same bill.² If one of several plaintiffs is competent to maintain the suit, the bill should not be dismissed because his co-plaintiffs have shown no right to sue;³ but the fact that the only person named as plaintiff purports to sue on behalf of all the shareholders will not save the bill from dismissal if he himself be disqualified.⁴

It has been held by an inferior court in Illinois that an objection to the competency of the complainant to act as plaintiff in a shareholder's bill cannot be raised by answer, but can only be taken by demurrer, if the incompetency appear on the face of the bill, or by plea in abatement if it do not so appear.⁵ Other grounds sufficient to sustain the decision were assigned; and it would seem difficult to maintain this ground. The objection is not dilatory, to the personal disability of the plaintiff, as an objection of coverture, but rather goes to the merits. Innumerable cases might be found in which the objection has been raised by answer.

§ 1165. **Whether the Interest of the Shareholders must be substantial.** — In one case the doctrine was announced, *obiter*, that a shareholder's bill cannot be maintained where the property of the company is encumbered to an amount greatly exceeding its value, so that the shareholder has no real, substantial interest therein.⁶ "In our opinion," said the court, "the \$14,678,634 of the new company's capital stock owned by the complainants, to protect which they are prosecuting this suit, is not intrinsically worth the twentieth part of a 'pepper-corn.' It is probably worth something for speculative purposes; but the courts are under no obligation to aid such enterprises. The defendant's road is in substance and in fact the property of the bondholders.

¹ *Arnold v. Searing* (N. J. Ch.), 67 Atl. 831.

⁴ *Infra*, § 1172.

² *Moyle v. Landers* (Cal.), 21 Pac. 1133. As to suing on behalf of the other shareholders, see *infra*, § 1172.

⁵ *City of Chicago v. Cameron*, 22 Ill. App. 91, 105.

⁶ *McHenry v. New York, etc. R. R. Co.*, 22 Fed. 130.

³ *Parrott v. Byers*, 40 Cal. 614.

. . . They are the beneficial owners of the corporate property, and the complainants have no such interest therein as entitles them to intervene.”¹ Although this doctrine may seem reasonable to a layman, it is submitted that so long as the corporation retains a technical interest in its property its shareholders should have the right to ask judicial intervention, however burdened with debts the company may be. The fact and not the amount of the shareholder’s interest gives him the right to file a shareholder’s bill.² To borrow a phrase from the passage just quoted, even an interest worth only “the twentieth part of a peppercorn” should be sufficient.³ Certainly, the authorities conclusively establish that the proportionate interest of the plaintiff may be infinitesimal without affecting his right to sue. A holder of one share is as competent to file a shareholder’s bill as a holder of ten thousand.⁴

§ 1166. **Motive of Complaining Shareholder as affecting his Right to act as Plaintiff.** — Where the plaintiff is a genuine shareholder, his right to maintain a shareholder’s bill in a proper case is not taken away because he also owns shares in a rival company,⁵ nor even because his motive in bringing the suit is friendliness to some other company,⁶ or personal spite,⁷ or other motive equally distinct from a real desire to promote the welfare of the company.⁸ But, on the other hand, while his motive is immaterial, yet if he appears to be the mere puppet of another company, acting under its directions, and by it indemnified against costs, the bill will be taken off the files as an imposition on the court, since the shareholder is but the nominal and not the real plaintiff.⁹

¹ *McHenry v. New York, etc. R. R. Co.*, 22 Fed. 130, 132-133.

² See *infra*, § 1181.

³ Cf. *Davies v. Monroe Water Works, etc. Co.*, 107 La. 145; 31 So. 694.

⁴ *Seaton v. Grant*, 2 Ch. 459, and innumerable other cases. See also *infra*, § 1181.

⁵ *Fraser v. Whalley*, 2 Hem. & Miller 19.

⁶ *Hattersley v. Earl of Shelburne*, 31 L. J. Ch. 873, 876-877; *Carson v. Iowa City Gaslight Co.*, 80 Iowa 638; 45 N. W. 1068.

Cf. *Forrester v. Boston, etc. Mining*

Co., 21 Mont. 544, 550-551; 55 Pac. 229; *Rogers v. Oxford, etc. Ry. Co.*, 2 De G. & J. 662; *Ffooks v. South Western Ry. Co.*, 1 Smale & G. 142.

⁷ *Seaton v. Grant*, 2 Ch. 459.

⁸ *Central R. R. Co. v. Collins*, 40 Ga. 582; *Jones v. Imperial Bank*, 23 Grant (Can.) 262, 275; *Hodge v. U. S. Steel Corp.*, 64 N. J. Eq. 111; 53 Atl. 553 (to be compared with s. c. in *Court of Errors*, 64 N. J. Eq. 807; 54 Atl. 1; 60 L. R. A. 742).

⁹ *Forrest v. Manchester, etc. Ry. Co.*, 4 De G. F. & J. 125; *Belmont v. Erie Ry. Co.*, 52 Barb. (N. Y.) 637.

Cf. *MacGinniss v. Boston, etc.*

§ 1167. **Disqualification of Shareholders who have participated or acquiesced in Transaction complained of.** — A shareholder who has assented to or acquiesced in the transaction impugned cannot maintain the suit on behalf of himself and other shareholders.¹ This is true although the transaction objected to is *ultra vires* of the corporation.² And the mere fact that the complaining shareholder protested verbally against the transaction will not prevent him from being disentitled to sue by acquiescence and failure promptly to make his opposition effective.³ Moreover, a

Mining Co., 29 Mont. 428, 462-463; 75 Pac. 89; *Breeze v. Lone Pine-Surprise, etc. Co.*, 81 Pac. 1050; 39 Wash. 602 (overruling demurrer to answer); *Rogers v. Oxford, etc. Ry. Co.*, 2 De G. & J. 662.

¹ *Burden v. Burden*, 159 N. Y. 287, 304; 54 N. E. 17; *Towers v. African Tug Co.* (1904), 1 Ch. 558; *Davenport v. Crowell* (Vt.), 65 Atl. 557; *Knoop v. Bohmrich*, 49 N. J. Eq. 82; 23 Atl. 118; *Burt v. British Nation Life Ass. Ass'n*, 4 De G. & J. 158 (complainant who was a director deemed to have acquiesced in prior transactions of which the minutes gave warning).

Cf. *Whitwam v. Watkin*, 78 L. T., n. s., 188; *Booth v. Land Filling, etc. Co.*, 59 Atl. (N. J.) 767; *Devine v. Frankford Steel, etc. Co.*, 205 Pa. St. 114; 54 Atl. 578 (where complainant's vote in favor of the transaction was procured by fraud); *Appleton v. American Malting Co.*, 54 Atl. 454; 65 N. J. Eq. 375 (holding that a shareholder who has participated in a dividend paid out of capital may maintain a shareholder's bill against the directors to compel them to restore to the company the amount of the illegal dividend).

But see *Shepaug Voting Trust Cases*, 60 Conn. 553, 574-575; 24 Atl. 32.

A mere casual expression of gratification at the action will not amount to an assent within the rule of the text: *Scanlan v. Snow*, 2 App. D. C. 137, 149.

² *Gregory v. Patchett*, 33 Beav. 595; *McNab v. McNab & Harlin Co.*, 62 Hun 18; 16 N. Y. Supp. 448 (affirmed in 133 N. Y. 687; 31 N. E. 627); *Alexander v. Searcy*, 81 Ga. 536; 8 S. E. 630; 12 Am. St. Rep. 337; *Pinkus v. Minneapolis Linen Mills*, 65 Minn. 40; 67 N. W. 643; *Hill v. Nisbet*, 100 Ind. 341; *Burgess v. St. Louis County R. R. Co.*, 99 Mo. 496; 12 S. W. 1050; *McCampbell v. Fountain Head R. R. Co.*, 77 S. W. 1070; 111 Tenn. 55; 102 Am. St. Rep. 731; *Towers v. African Tug Co.* (1904), 1 Ch. 558 (shareholder knowingly receiving dividend paid out of capital disentitled from maintaining suit against directors for declaring same without offering to refund his share); *Stewart v. Erie, etc. Transportation Co.*, 17 Minn. 372; *Terry v. Eagle Lock Co.*, 47 Conn. 141; *Wormser v. Metropolitan Street Ry. Co.*, 184 N. Y. 83; 112 Am. St. Rep. 596; *Hill v. Atlantic, etc. R. R. Co.* (N. Car.), 55 S. E. 854; *Kent v. Quicksilver Mining Co.*, 78 N. Y. 159, 185; *Graham v. Birkenhead, etc. Ry. Co.*, 2 Mac. & G. 146.

Cf. *Memphis, etc. R. R. Co. v. Grayson*, 88 Ala. 572; 7 So. 122; 16 Am. St. Rep. 69 (holding that when the company by corporate action repudiates the transaction, the disqualification of an acquiescing shareholder to file a bill to set it aside is removed).

³ *Watt's Appeal*, 78 Pa. St. 370; *Post v. Beacon, etc. Co.*, 84 Fed. 371.

shareholder who accepts any benefit under a contract cannot maintain a bill to set the agreement aside as fraudulent and illegal, even though at the time of accepting the benefit he notified the company that such acceptance was without prejudice to his right to attack the validity of the contract.¹ Such a defence is available although the complaining shareholder, if he has not been joined by any other shareholders, did not accept any benefit from the transaction until after the commencement of the suit.²

§ 1168. **Laches of Shareholder as Disqualification.** — So, a shareholder may be barred by laches, to the same extent as by affirmative assent, from acting as plaintiff in a shareholder's suit.³ Where fraudulently excessive salaries have been fixed by the directors, a shareholder who has raised no objection for several years will then be barred from objecting to the payments for services already rendered, but will not be precluded from insisting that for the future the unreasonable salaries shall not be paid.⁴ The fact that an application has been addressed to the attorney-general praying him to intervene in a matter of corpo-

¹ *Wormser v. Metropolitan Street Ry. Co.*, 98 N. Y. App. Div. 29; 90 N. Y. Supp. 714; affirmed in 184 N. Y. 83; 112 Am. St. Rep. 596.

² *Wormser v. Metropolitan Street Ry. Co.*, 184 N. Y. 83; 112 Am. St. Rep. 596.

³ *Peabody v. Flint*, 6 Allen (Mass.) 52; *Snow v. Boston Blank Book Mfg. Co.*, 158 Mass. 325; 33 N. E. 588; *Dunphy v. Traveller Newspaper Ass'n*, 146 Mass. 495; 16 N. E. 426; *Keeney v. Converse*, 99 Mich. 316; 58 N. W. 325; *Streight v. Junk*, 59 Fed. 321; 8 C. C. A. 137; *Burgess v. St. Louis County R. R. Co.*, 99 Mo. 496; 12 S. W. 1050; *Cullen v. Coal Creek, etc. Co.*, 42 S. W. 693 (Tenn.); *Kessler v. Ensley Co.*, 123 Fed. 546; *Boldenwick v. Bullis* (Colo.), 90 Pac. 634; *Rabe v. Dunlap*, 51 N. J. Eq. 40; 25 Atl. 959; *Moore v. Silver Valley Mining Co.*, 104 N. Car. 534; 10 S. E. 679.

Cf. *Clinch v. Financial Corporation*, 4 Ch. 117; *Brinkerhoff v. Roosevelt*, 143 Fed. 478 (shareholder

not bound to assume possibility of wrongdoing on the part of directors), and *Morgan v. King*, 27 Colo. 539; 63 Pac. 416, in which cases the complainant shareholder was held under the circumstances not to have been guilty of laches. As to what constitutes laches on the part of a shareholder, see further *Kessler & Co. v. Ensley Co.*, 129 Fed. 397; *Edwards v. Mercantile Trust Co.*, 124 Fed. 381; *Kimbell v. Hydraulic Press Brick Co.*, 119 Fed. 102; 55 C. C. A. 162 (where the company's books, which were open to inspection by shareholders, disclosed the transaction complained of).

It has recently been held that laches of a shareholder for a shorter period of time than that allowed by the statute of limitations cannot be availed of on demurrer but must be asserted by answer. *Sabre v. United Traction, etc. Co.*, 156 Fed. 79.

⁴ *Lillard v. Oil, Paint & Drug Co.* (N. J.), 56 Atl. 254.

rate management will excuse a shareholder for delaying the institution of a shareholder's suit until the attorney-general's determination is made known.¹ The laches of a shareholder which will disentitle him to maintain a shareholder's bill is closely allied to, but distinct from, the laches of the shareholders collectively — that is, of the corporation; but of course where the corporation is barred by laches from complaining no shareholder could complain in its right,² although an individual shareholder may be precluded from suing where the corporation would not be barred.³

§ 1169. **Right of Transferee of Shares to sue on account of Transactions which took Place prior to the Transfer** — *In general.* — A shareholder is not debarred from suing because he purchased his shares after the transaction complained of,⁴ and even for the purpose of qualifying himself to bring the suit.⁵ According to some authorities, it is no objection that he purchased his shares from holders who were barred from suing by assent or acquiescence,⁶ nor even that the shares which he purchased were part of an issue the legality of which the suit is instituted to question, if he took without knowledge of that fact;⁷ but by the weight of American authority a transferee of shares cannot maintain a

¹ *Burrows v. Interborough Met. Co.*, 156 Fed. 389.

² *Hart v. Ogdensburg, etc. R. R. Co.*, 89 Hun (N. Y.) 316, 322; 35 N. Y. Supp. 566.

Cf. *Cullen v. Coal Creek, etc. Co.*, 42 S. W. Rep. 693 (Tenn.) where the company was barred by limitations.

³ Cf. *Pacific R. R. Co. v. Missouri Pac. Ry. Co.*, 111 U. S. 505; 4 Sup. Ct. 583 (stated *infra*, § 1189).

⁴ *State v. Port Royal, etc. Ry. Co.*, 45 S. Car. 470, 472; 23 S. E. 383; *Montgomery Light, etc. Co. v. Lahey*, 121 Ala. 131; 25 So. 1006 (semble); *Winsor v. Bailey*, 55 N. H. 218; *City of Chicago v. Cameron*, 22 Ill. App. 91.

Cf. *Forrester v. Boston, etc. Mining Co.*, 21 Mont. 544, 549–550, 565; 55 Pac. 229. But see *infra*, § 1170, § 1171.

As to a bill by persons who acquire shares from the corporation

subsequent to the transactions complained of, see *Mackey v. Burns*, 64 Pac. 485; 16 Colo. App. 6; *Colgate v. U. S. Leather Co.* (N. J.), 67 Atl. 657.

⁵ *Bloxam v. Metropolitan Ry. Co.*, 3 Ch. 337; *Seaton v. Grant*, 2 Ch. 459; *Hare v. London, etc. Ry. Co.*, Johns. 722; *Carson v. Iowa City Gaslight Co.*, 80 Iowa 638; 45 N. W. 1068; *Jones v. Imperial Bank*, 23 Grant (Can.) 262; *Ramsey v. Gould*, 57 Barb. (N. Y.) 398.

But see *Pitcher v. Lone Pine-Surprise, etc. Co.* (Wash.), 81 Pac. 1047.

Cf. *Ervin v. Oregon Ry., etc. Co.*, 28 Hun (N. Y.) 269.

⁶ *Montgomery Light, etc. Co. v. Lahey*, 121 Ala. 131; 25 So. 1006 (semble).

⁷ *London Trust Co. v. Mackenzie*, 62 L. J. Ch. 870, 877. But see *Venner v. Atchison, etc. R. Co.*, 28 Fed. 581, 591.

shareholder's bill on account of any transaction in which the transferor had acquiesced.¹ At any rate, a purchaser of shares may insist that a stop be put to an *ultra vires* practice or course of dealing which had been authorized by his predecessor in title.² The fact that shares were voted by a pledgee in favor of a transaction will prevent the pledgor from filing a shareholder's bill to complain thereof.³

§ 1170. *Under Rule 94 of the Equity Rules of the Supreme Court of the United States.* — Some of the propositions laid down in the preceding paragraph with regard to the law generally are modified as to suits in the federal courts by a rule of practice in equity promulgated by the Supreme Court under statutory authority.⁴ Shareholders' suits had become very frequent in the

¹ *Parsons v. Hayes*, 14 Abb. N. C. (N. Y.) 419, 433, 435; *Langdon v. Fogg*, 14 Abb. N. C. (N. Y.) 435 n.; *Trimble v. Am. Sug. Ref. Co.*, 61 N. J. Eq. 340; 48 Atl. 912; *McC Campbell v. Fountain Head R. R. Co.*, 77 S. W. 1070; 111 Tenn. 55; 102 Am. St. Rep. 731; *Hodge v. United States Steel Corp.*, 64 N. J. Eq. 90, 92; 53 Atl. 601 (to be compared with s. c. in Court of Errors; 64 N. J. Eq. 807, 809; 54 Atl. 1; 60 L. R. A. 742); *Venner v. Atchison, etc. R. Co.*, 28 Fed. 581, 591; *Farwell v. Babcock* (Tex.), 65 S. W. 509; 27 Tex. Civ. App. 162; *Gumaer v. Cripple Creek, etc. Co.* (Colo.), 90 Pac. 81, 86; *Clark v. Am. Coal Co.*, 86 Iowa 436, 445-447; 53 N. W. 291; 17 L. R. A. 557 (holding that a bona fide purchaser has no greater rights, because the share-certificates are not negotiable. *Sed quære.*).

Cf. *Erny v. G. W. Schmidt Co.*, 197 Pa. St. 475; 47 Atl. 877; *Ffooks v. South Western Ry. Co.*, 1 Smale & G. 142, 168.

² *McC Campbell v. Fountain Head R. R. Co.*, 77 S. W. 1070; 111 Tenn. 55; 102 Am. St. Rep. 731.

³ *Manufacturers, etc. Bank v. Big Muddy Iron Co.*, 97 Mo. 38, 45-46 (headnote inadequate); 10 S. W. 865.

⁴ Rule 94, 104 U. S. IX. As to

this rule of court, see *supra*, § 1157 note, and *Church v. Citizens' St. R. Co.*, 78 Fed. 526; *Earle v. Seattle, etc. Ry. Co.*, 56 Fed. 909 (holding that the Rule does not apply to removed cases); *Edwards v. Mercantile Trust Co.*, 124 Fed. 381; *Elkins v. Chicago*, 119 Fed. 957; *Dickenson v. Consolidated Traction Co.*, 114 Fed. 232 (affirmed on other grounds in s. c., 119 Fed. 871; 56 C. C. A. 401); *Taylor v. Decatur Mineral, etc. Co.*, 112 Fed. 449; *Bimber v. Calivada Colonization Co.*, 110 Fed. 58; *Eldred v. American Pal. Car Co.*, 99 Fed. 168 (for other proceedings in this litigation, see s. c., 96 Fed. 59, and 103 Fed. 209, in the same court; and 105 Fed. 455; 45 C. C. A. 1, and 105 Fed. 457; 44 C. C. A. 554 on appeal); *Perkins v. Northern Pac. Ry. Co.*, 155 Fed. 445; *Ball v. Rutland Ry. Co.*, 93 Fed. 513; *Weir v. Bay State Gas Co.*, 91 Fed. 940; *Clarke v. Eastern Bldg., etc. Ass'n*, 89 Fed. 779; *Old Colony Trust Co. v. Dubuque, etc. Traction Co.*, 89 Fed. 794; *Poor v. Iowa Central Ry. Co.*, 155 Fed. 226; *Burrows v. Interborough Met. Co.*, 156 Fed. 389; *Quincy v. Steel*, 120 U. S. 241; 7 Sup. Ct. 520; *Maeder v. Buffalo Bill's Wild West Co.*, 132 Fed. 280 (holding that the provisions of the Rule requiring bill to be verified by

federal courts, and were often resorted to collusively for the purpose of giving the federal courts jurisdiction over causes of action by a corporation against citizens of its own state when the company was not really unwilling to institute the appropriate legal proceedings, but went through the form of refusing to institute suit in order to enable the litigation to be carried on in the federal courts.¹ Where such collusion could be proved, the case would be dismissed for want of federal jurisdiction;² but in order to give still more effective remedies the rule of practice above cited was adopted. In order to comply with this rule, every shareholder's bill must contain an allegation that "the plaintiff was a shareholder at the time of the transaction of which he complains, or that his share had devolved upon him since by operation of law."³ This allegation is made a material one, and must be proved.⁴ The Rule applies only to suits by a shareholder to enforce a right of the corporation, and not to suits to enforce individual rights of the shareholder, such as a suit for rescission of a contract of subscription to shares on the ground of fraud,⁵ or to suits for a dissolution and winding-up of the corporation.⁶

§ 1171. *Cases in State Courts applying Law as altered by Rule 94.* — Some state courts, misapplying, as it would seem, the federal cases decided under this rule of court, have

affidavit does not apply to removed cases); *Evans v. Union Pac. Ry. Co.*, 58 Fed. 497 (also relating to removed cases); *Kimball v. City of Cedar Rapids*, 99 Fed. 130 (holding that the Rule does not apply to a suit over which the federal courts have jurisdiction independently of diversity of citizenship); *Venner v. Great Northern Ry. Co.*, 153 Fed. 408; 209 U. S. 24 (a removed case); *Gage v. Riverside Trust Co.*, 156 Fed. 1002 (holding that where Rule is not complied with the corporation must for jurisdictional purposes be treated as a plaintiff).

¹ *Hawes v. Oakland*, 104 U. S. 450, 452-453; *Detroit v. Dean*, 106 U. S. 537; 1 Sup. Ct. 560. As to what facts are necessary in order to establish such collusion, see *Mills v. City of Chicago*, 143 Fed. 430,

affirmed *sub nom.* *Chicago v. Mills*, 204 U. S. 321; *New Albany Waterworks v. Louisville Banking Co.*, 122 Fed. 776 (contributions by other minority shareholders, who are citizens of same state as the corporation, to the expenses of the suit not sufficient to establish collusion).

² *Detroit v. Dean*, 106 U. S. 537; 1 Sup. Ct. 560; *Kemmerer v. Hagerty*, 139 Fed. 693.

³ See *Dannmeyer v. Coleman*, 11 Fed. 97; *McHenry v. New York, etc. R. R. Co.*, 22 Fed. 130.

⁴ *Dimpfel v. Ohio, etc. Ry. Co.*, 110 U. S. 209; 3 Sup. Ct. 573; *Robinson v. West Va. Loan Co.*, 90 Fed. 770.

⁵ *Barcus v. Gates*, 89 Fed. 783; 32 C. C. A. 337.

⁶ *Briggs v. Traders Co.*, 145 Fed. 254.

announced that by general principles of law a shareholder's bill cannot be maintained when the acts complained of took place before the plaintiff purchased his shares, and these authorities have themselves been followed by other courts¹ in spite of other authorities which point out the error of applying the federal cases decided under Rule 94 to shareholders' bills in the state courts.² Certainly it is not altogether clear how far the Supreme Court regarded Rule 94 as merely declaratory and how far as altering the law. The decisions just cited and all which agree with them hold, *a fortiori*, that a shareholder's bill cannot be maintained by one who acquired his shares from a person who was either implicated in the transaction complained of or who, by laches, acquiescence, or the like, would have been disabled from acting as plaintiff in a similar suit.³

§ 1172. **Plaintiff as Representative of other Shareholders.**—As a shareholder's suit is brought for a wrong to the corporation, which but for exceptional circumstances would be the only proper plaintiff, the complaining shareholder should sue as the

¹ *Home Fire Ins. Co. v. Barber*, 93 N. W. 1024; 67 Nebr. 644; 60 L. R. A. 927 (semble); *Miller v. Murray*, 17 Colo. 408; 30 Pac. 46; *Boldenweck v. Bullis* (Colo.), 90 Pac. 634; *Colgate v. U. S. Leather Co.* (N. J.), 67 Atl. 657 (declaring that the right to object to a consolidation with another corporation under a statute passed after the organization of the first company is personal to those who were shareholders at the time of the passage of the act and cannot be set up by one who acquires shares afterwards); *Alexander v. Searcy*, 81 Ga. 536; 8 S. E. 630; 12 Am. St. Rep. 337 (semble).

Cf. *Rankin v. Southwestern Brewery, etc. Co.* (N. Mex.), 73 Pac. 614 (a case in a territorial court); *Moore v. Silver Valley Mining Co.*, 104 N. Car. 534, 544-545; 10 S. E. 679 (where the court said, "It appears that he was the *bona fide* owner of the stock; that he bought the same in good faith and not for mere vexatious purposes"); *Dissette v. Lawrence Pub. Co.*, 9 Oh. Circ. Ct.

Rep., N. S., 118, 120 (approving the passage just quoted from the opinion of the North Carolina Court); *O'Connor v. Virginia Pass., etc. Co.*, 46 N. Y. Misc. 530, 535-536; 92 N. Y. Supp. 525 (laying down substantially the same rule); *Venner v. Great Northern Ry. Co.*, 153 Fed. 408 (applying Rule 94 to a case removed from a state court); 209 U. S. 24.

² *Forrester v. Boston, etc. Mining Co.*, 21 Mont. 544, 565-568; 55 Pac. 229; *City of Chicago v. Cameron*, 22 Ill. App. 91; 2 Morawetz on Priv. Corps., 2d ed., § 266. See also article by Murray Seasongood, Esq., in 21 Harv. L. Rev. 195.

Cf. *Earle v. Seattle, etc. Ry. Co.*, 56 Fed. 909 (holding that a bill originally filed in a state court and afterwards removed to a federal court need not comply with Rule 94). *Evans v. Union Pac. Ry. Co.*, 58 Fed. 497 (similar point).

³ *Home Fire Ins. Co. v. Barber*, 60 L. R. A. 927; 67 Nebr. 644; *Young v. Commissioners of Mahoning Co.*, 53 Fed. 895.

representative of the aggregate rights of the shareholders—that is to say, “on behalf of himself and all others the shareholders,” etc.; and hence a bill filed on his own behalf alone will be dismissed.¹ But although this is the general rule with respect to shareholders’ bills, yet where the suit is brought to enjoin some action which is *ultra vires* of the company, it has been held that the complaining shareholder may sue as an individual,² since the threatened excess of power constitutes, in a sense, an individual wrong to each member.³

The bill may be maintained by one shareholder on behalf of all the others, although some of the latter have acquiesced in the transactions complained of,⁴ and would therefore be debarred from appearing as plaintiffs themselves,⁵ or although the citizenship of some of them is such that if they were named as plaintiffs the jurisdiction of the court would be ousted.⁶ But where there

¹ *Mozley v. Alston*, 1 Phillips Ch. 790 (headnote inadequate); *Alton v. Curtis*, 26 Conn. 456, 462 (semble); *White v. Carmathen Ry. Co.*, 1 Hem. & Mill. 786; *Winsor v. Bailey*, 55 N. H. 218; *McAfee v. Zettler*, 103 Ga. 579; *Bethune v. Wells*, 94 Ga. 486.

But see *Chicago v. Cameron*, 120 Ill. 447; 11 N. E. 899; *Zinn v. Baxter*, 65 Oh. St. 341; 62 N. E. 327 (where the bill was filed on behalf of such only of the shareholders as might wish to become parties).

Cf. *Putnam v. Sweet*, 1 Chand. (Wisc.) 286, 338 (where an objection that a shareholder could not sue on behalf of himself and all others was with manifest propriety overruled); *McCrea v. McClenahan*, 114 N. Y. App. Div. 70 (where it was held improper for plaintiff to join all the other shareholders as defendants instead of suing on behalf of all); *Arnold v. Searing* (N. J. Ch.), 67 Atl. 831 (where the plaintiff having sued on behalf of all other stockholders and bondholders, the court, considering the word “bondholders” as an inadvertence and treating the bill as if amended so as to omit it, overruled a demurrer). *Wicker-*

sham v. Crittenden, 93 Cal. 17, 33–34; 28 Pac. 788; *Hearst v. Putnam Mining Co.* (Utah), 77 Pac. 753; 28 Utah 184; 107 Am. St. Rep. 698; 66 L. R. A. 784; *Jefferson County Sav. Bank v. Francis*, 115 Ala. 317.

As to right of the complainant in a shareholder’s bill to consent to a dismissal of the bill in consideration of a payment to him individually, see *Bird Coal & Iron Co. v. Humes*, 157 Pa. St. 278; 27 Atl. 750; 37 Am. St. Rep. 727 (stated *infra*, § 1613).

² *Hoole v. Great Western Ry. Co.*, 3 Ch. 262. Cf. *Zabriskie v. Cleveland, etc. R. R. Co.*, 23 How. 381, 395 (where the court said that “the usual and more approved form of such a suit” is for one or more stockholders to sue on behalf of all).

But see *White v. Carmathen Ry. Co.*, 1 Hem. & Miller 786.

³ *Supra*, § 1153.

⁴ *Clinch v. Financial Corporation*, 4 Ch. 117.

But see *Ffooks v. South Western Ry. Co.*, 1 Smale & G. 142, 165, 166.

⁵ *Supra*, § 1167.

⁶ *New Albany Waterworks v. Louisville Banking Co.*, 122 Fed. 776.

are several distinct classes of shareholders, as preferred and ordinary, and where the acts complained of injure one class only, the plaintiff cannot sue on behalf of both classes.¹ Upon a similar principle, wherever the rights of the several shareholders are separate and distinct, one cannot sue on behalf of all. Thus, it has been held that where an illegal dividend has been declared, the rights of the several shareholders become separate, and that therefore one cannot maintain a bill on behalf of all to enjoin its payment;² but this decision rests on a misconstruction of *Carlisle v. South Eastern Ry. Co.*³ In the last mentioned case a railway company issued certain new shares upon the terms that no dividends should be paid thereon until a certain line of railway should be completed, and a holder of such shares filed a bill to enjoin the company from paying what he alleged to be an illegal dividend on the other shares. The Chancellor held that after such dividend was declared the rights of the two classes of shareholders became so far distinct with reference thereto that the bill could not be maintained without some one before the court as representative of the holders of the original shares, — a ruling which is far from warranting the conclusion drawn from it by the New York court.

The fact that some of the shareholders on behalf of whom the plaintiff purports to sue would have been competent to maintain the suit will not justify the court in refusing to dismiss the bill if he himself be disqualified.⁴

§ 1173. *Intervention by other Shareholders.* — Any shareholder may come in by petition and be made a party plaintiff to the suit,⁵ provided he might originally have filed the bill; but where he had ceased to be a member of the company before suit brought he cannot thus intervene.⁶ Nor will a shareholder be permitted to intervene for the purpose of interposing obstacles to the prosecution of the suit.⁷ A shareholder who has been admitted as an additional party plaintiff may prosecute the suit successfully even though the original plaintiff had sold his shares

¹ *Lord v. Governor & Co. of Ass. Ass'n*, 4 De G. & J. 158, 173-*Copper Miners*, 2 Phillips Ch. 740, 174.

751. Cf. *infra*, § 1177.

⁵ Cf. *Coltrane v. Templeton*, 106

² *Carpenter v. New York, etc.* Fed. 370; 45 C. C. A. 328.

R. R. Co., 5 Abb. Pr. 277.

⁶ *Scanlon v. Snow*, 2 App. D.C. 137.

³ 1 Mac. & G. 689.

⁷ *Forbes v. Memphis, etc. R. R.*

⁴ *Burt v. British Nation Life Co.*, 2 Woods 323.

before bringing suit or for any other reason applicable to himself individually has no ground of complaint.¹ So, too, after other shareholders have been admitted as co-plaintiffs, the matters in controversy cannot be compromised by the original complainant over their objection, but they are entitled to go on with the suit upon indemnifying the original plaintiff against further costs and paying their *pro rata* share of the costs already incurred.²

§ 1174-§ 1178. *Parties Defendant.*

§ 1174. **The Company as a necessary Party Defendant.** — Since every shareholder's suit is brought to enforce a right of action upon which the corporation would be the regular plaintiff, it follows that the company ought to be made in some way a party, in order that the decision may be binding upon it and that further litigation may thus be prevented. As the impossibility of making it a party plaintiff forms the reason for allowing the shareholder to sue, it must be made a defendant; and accordingly a shareholder's bill to which the corporation is not a party defendant is demurrable.³ This is true, although the company has long since abandoned its business and franchises,

¹ *Hanna v. Lyon*, 179 N. Y. 107; 6 G. & J. 94; 26 Am. Dec. 559; 71 N. E. 778.

But see *Belmont v. Erie Ry. Co.*, 52 Barb. (N. Y.) 637, 663 (headnote inadequate).

² *McAlpin v. Universal Tobacco Co.* (N. J.), 57 Atl. 418.

³ *Davenport v. Dows*, 18 Wall. 626; *Spokes v. Grosvenor Hotel, etc. Co.* (1897), 2 Q. B. 124 (semble); *Byers v. Rollins*, 13 Colo. 22; 21 Pac. 894; *Putnam v. Sweet*, 1 Chand. (Wisc.) 286, 337-338, s. c. 2 Pinn. (Wisc.) 302; *Robinson v. Smith*, 3 Paige (N. Y.) 222, 232-233; 24 Am. Dec. 212; *Hersey v. Veazie*, 24 Me. 9; 41 Am. Dec. 364; *Barry v. Moeller*, 59 Atl. (N. J.) 97; *Zinn v. Baxter*, 65 Oh. St. 341; 62 N. E. 327; *Morshead v. Southern Pac. Co.*, 123 Fed. 350; *Peck v. Peck*, 33 Colo. 421; 80 Pac. 1063.

Contra: *Kyle v. Wagner*, 45 W. Va. 349; 32 S. E. 213. An early Maryland case, *Campbell v. Poultney*,

which is also contra, must be deemed to be overruled. See *Booth v. Robinson*, 55 Md. 419, 439 (semble); *Wilkins v. Thorne*, 60 Md. 253.

In *Baldwin v. Canfield*, 26 Minn. 43, 59; 1 N. W. 261, it was declared that the corporation was not a necessary party to a suit by a pledgee of its shares, the ultimate object of which was to remove a cloud on the company's title to land; but this view is inconsistent with the cases just cited in support of the statement in the text, and would not be generally adopted.

See also *Langolf v. Seiberlitch*, 2 Pars. Eq. Cas. (Pa.) 64, 78; *Kidd v. New Hampshire Traction Co.* (N. H.), 56 Atl. 465 (where the company was a foreign corporation); *Green v. Compton*, 41 N. Y. Misc. 21; 83 N. Y. Supp. 588 (holding that the company is not a necessary party to a statutory action by one director

unless it has been legally dissolved.¹ In one English case² it was held that the company was not a necessary party to a bill by a shareholder to set aside an *ultra vires* transaction; but the reason assigned for this conclusion was that the company, which was formed under the Companies Act of 1844, was a corporation for some purposes only, and hence (even if this premiss were conceded to be true) the case could not be deemed authority with respect to companies formed under the English Act of 1862 or under the American Statutes, all of which are undoubtedly full-orbed corporations. If the company is named in the bill as defendant but is not served with process before the hearing, the bill will be dismissed.³ A prayer that a "trustee" be appointed for the company to hold whatever money may be recovered as a result of the suit does not obviate the necessity of making the corporation a defendant.⁴

§ 1175. *The Company when Defendant is Defendant for all Purposes.* — When the company is made defendant, it is a defendant for all purposes, and hence, although the object of the suit is to enforce its rights, and although no relief is prayed against it, discovery may be obtained from it to the same extent as from any other defendant.⁵ So, the company will be deemed a party defendant for the purpose of determining whether the federal courts have jurisdiction of the controversy on the ground of diversity of citizenship.⁶

to enjoin threatened wrongful acts by his colleagues); *Miller v. Barlow*, 78 N. Y. App. Div. 331; 79 N. Y. Supp. 964 (same point as preceding case).

¹ *Wilkins v. Thorne*, 60 Md. 253, 259 (headnote inadequate); *Allen v. New Jersey Southern R. R. Co.*, 49 How. Pr. (N. Y.) 14.

² *Gregory v. Patchett*, 33 Beav. 595, 608.

³ *Samuel v. Holladay*, 1 Woolwich 400, 414; *Deming v. Beatty Oil Co.*, 72 Kans. 614; 84 Pac. 385 (where plaintiff sought to introduce an exception to the rule on the ground that otherwise a failure of justice would necessarily result); *Eldred v. Am. Palace Car Co.*, 105 Fed. 457; 44 C. C. A. 554.

⁴ *Deming v. Beatty Oil Co.*, 72 Kans. 614; 84 Pac. 385.

⁵ *Spokes v. Grosvenor Hotel, etc. Co.* (1897), 2 Q. B. 124.

⁶ *Groel v. United Electric Co.*, 132 Fed. 252 (containing a full and clear analysis of earlier cases); *Doctor v. Harrington*, 196 U. S. 579; 25 Sup. Ct. 355; *Redfield v. Baltimore, etc. R. R. Co.*, 124 Fed. 929; *McClelland v. McKane*, 154 Fed. 164; *Venner v. Great Northern Ry. Co.*, 209 U. S. 24.

Cf. *Jacobs v. Mexican Sugar Refining Co.*, 104 N. Y. App. Div. 242, 248 (headnote inadequate); 93 N. Y. Supp. 776; *Gage v. Riverside Trust Co.*, 156 Fed. 1002.

§ 1176. **Parties Defendant other than the Corporation — In general.** — To determine what outside parties are necessary — that is, parties other than the corporation and the complaining shareholders — the ordinary principles of equity procedure must be consulted. Certainly, there must be some other defendant besides the company;¹ for otherwise, inasmuch as the corporation is in substance a plaintiff, the anomaly would be presented of a suit without any substantial defendant.² Wherever the bill is filed to enforce some right of action of the company against a stranger, or to set aside any transaction between the company and a stranger, such stranger may,³ and indeed must,⁴ be made a party. Thus, where the object of the suit is to enjoin as fraudulent and *ultra vires* an agreement between the company and another corporation, the latter is a necessary party.⁵ So, where a shareholder seeks to enjoin an amalgamation with another company, the latter must be a party to the suit.⁶ On the other hand mere agents or subordinates should not be made parties. Thus, where a bill is filed to set aside a contract between the company and the owner of a majority of the stock, the agent of the latter who merely executed the contract on his behalf and acted as his proxy at a shareholders' meeting is improperly joined as defendant.⁷

In a recent case where a shareholder in a holding company sued to obtain redress for a lease executed by a corporation all of whose shares were owned by the holding company, it was held that the subsidiary corporation and the lessee corporation were not necessary parties.⁸ But the principle of this decision is a little difficult to understand.

¹ *Edwards v. Bay State Gas Co.*, 91 Fed. 942. *Pac. Ry. Co.*, 129 Fed. 305; 63 C. C. A. 537; *Nankivell v. Benjamin*, 18 Vict. L. R. 543.

² A bill filed to enjoin an *ultra vires* act is not filed merely in the right of the company, but, as shown above, in the shareholder's individual right, and therefore to such a bill the corporation may sometimes be the sole defendant.

³ *Lund v. Blanshard*, 4 Hare 9.

⁴ *Russell v. Wakefield Waterworks Co.*, 20 Eq. 474, 481 (semble, per Jessel, M. R.); *Langan v. Francklyn*, 29 Abb. N. C. (N. Y.) 102; 20 N. Y. Supp. 404; *Weidenfeld v. Northern*

But see *Brewer v. Boston Theatre*, 104 Mass. 378, 399.

⁵ *Booth v. Robinson*, 55 Md. 419.

⁶ *Parker v. River Dam Nav. Co.*, 1 De G. & Sm. 192.

But see *Blatchford v. Ross*, 37 How. Pr. (N. Y.) 110.

⁷ *Mumford v. Ecuador Development Co.*, 111 Fed. 639.

⁸ *Sabre v. United Traction, etc. Co.*, 156 Fed. 79.

§ 1177. *Representatives of Classes of Shareholders whose Interests conflict with those of Complainant.* — Where there are several distinct classes of shares which are affected differently by the subject of the suit, a representative of each class should regularly be made a party, either as plaintiff or defendant.¹ This rule applies, however, only when the shareholders are divided into classes by the constitution of the company, and not where they are divided into classes by their own varying desires. For example, where some of the shareholders have assented to an *ultra vires* agreement, a representative of such assenting shareholders is not a necessary party to a bill by another shareholder to set it aside.² But to a suit for cancellation of certain shares it would seem that a representative of the holders of such shares is a necessary party defendant;³ although it is sufficient for one of such holders to be made a party as the representative of all.⁴ Where some of the shares sought to be cancelled have been transferred, the transferee may be joined as defendant without risk of making the bill multifarious.⁵ Likewise, it has been thought that in a suit to enjoin the collection of a fraudulent call somebody should be made a party as representative of the shareholders who have paid the call.⁶ Directors, whose duty is to represent all classes of shareholders impartially, cannot be made parties as the representatives of one class of shareholders.⁷

§ 1178. *Majority Shareholders and Directors.* — Although the foundation for a shareholder's bill is generally wrongful

¹ *Bailey v. Birkenhead, etc. Ry. Co.*, 12 Beav. 433; *Cramer v. Bird*, 6 Eq. 143.

Cf. *Carlisle v. South Eastern Ry. Co.*, 1 Mac. & G. 689 (stated supra, § 1172); *Lord v. Governor & Company of Copper Miners*, 2 Phillips Ch. 740, 751; *Hamlin v. Toledo, etc. R. R. Co.*, 78 Fed. 664, 672; 24 C. C. A. 271; 36 L. R. A. 826.

² *Clinch v. Financial Corporation*, 4 Ch. 117.

³ Cf. *Hoole v. Great Western Ry. Co.*, 3 Ch. 262; *Weidenfeld v. Northern Pacific Ry. Co.*, 129 Fed. 305; 63 C. C. A. 537.

But see *Ex parte Holmes*, 5 Cow. (N. Y.) 426 (holding that to a special summary statutory pro-

ceeding to determine the validity of an election of directors the persons whose right to vote as shareholders is in issue are not necessary parties); *Ribon v. Railroad Companies*, 16 Wall. 446 (representative of shareholders assenting to a reorganization scheme held to be necessary party to bill by dissenting shareholder to set aside amicable foreclosure sale made to carry out the agreement).

⁴ *Hoole v. Great Western Ry. Co.*, 3 Ch. 262.

⁵ *Montgomery Traction Co. v. Harmon*, 140 Ala. 505; 37 So. 371.

⁶ *Bailey v. Birkenhead, etc. Ry. Co.*, 12 Beav. 433.

⁷ *Chase v. Vanderbilt*, 62 N. Y. 307.

action, or a wrongful refusal to sue a wrongdoer, on the part of the majority of the shareholders or of the directors, yet neither the majority shareholders of the corporation, nor the directors, are always indispensable parties.¹ Obviously, where the action complained of is the action of a majority of a numerous body of shareholders, it is not possible to make all of them parties.² Where the ringleaders are made defendants, it is not necessary to join the mere tools.³ However, shareholders or directors who participated in the alleged wrongful acts are proper parties defendant, although no specific relief is prayed against them.⁴ A director who has not been guilty of any wrong is not even a proper party to the bill,⁵ and so also it is error to join as defendants shareholders against whom no wrong is charged and against whom no relief is prayed.⁶

§ 1179-§ 1182. *Averments of Bill.*

§ 1179. **Averments which would have been Necessary if the Company were Plaintiff.** — The bill, being founded on the right of the company, should in general contain averments of all facts that would have been necessary to enable the company to sue.⁷ But in the nature of things this rule may have exceptions.⁸ Thus, in a suit by a corporation to rescind a fraudulent contract, the plaintiff should offer to restore the consideration; but where a shareholder is suing to secure the same relief on the ground that the company is in control of the fraudulent parties,

¹ *Winch v. Birkenhead, etc. Ry. Co.*, 5 De G. & Sm. 562 (directors not necessary parties to bill to enjoin an *ultra vires* act).

But see *Slattery v. St. Louis, etc. Transportation Co.*, 91 Mo. 217.

² *Barry v. Moeller*, 59 Atl. (N. J.) 97.

Cf. *O'Connor v. Virginia Pass., etc. Co.*, 184 N. Y. 46, 50 (headnote inadequate); 76 N. E. 1082; *Brewer v. Boston Theatre*, 104 Mass. 378, 399 (directors who are in complicity with wrongdoer not necessary parties). In *Brown v. Utopia Land Co.*, 103 N. Y. Supp. 50 (headnote inadequate); a shareholder's bill was held demurrable partly on the ground

that the directors were not made defendants.

³ *Woodroof v. Howes*, 88 Cal. 184; 26 Pac. 111.

⁴ *Stone v. Pontiac, etc. R. R. Co.*, 102 N. W. 752; 139 Mich. 265.

Cf. *Moyle v. Landers* (Cal.), 21 Pac. 1133.

⁵ *Mulheran v. Gebhardt*, 93 N. Y. App. Div. 98; 86 N. Y. Supp. 941.

⁶ *McCrea v. McClenahan*, 114 N. Y. App. Div. 70.

⁷ *Kavanaugh v. Commonwealth Trust Co.*, 181 N. Y. 121; 73 N. E. 562.

⁸ Cf. *Weir v. Bay State Gas Co.*, 91 Fed. 940 (as to the degree of particularity requisite in charging fraud); and *infra*, § 1180.

who of course have also control of the property, no such offer could reasonably be exacted of the plaintiffs.¹ The decree, however, should certainly be so framed that the transaction should not be rescinded without restoration of the consideration which had passed to the company.²

§ 1180. **Degree of Particularity required.** — Of course it is desirable for the complaining shareholder to set out with all practicable detail the wrongful acts on account of which he is suing. Nevertheless, an allegation that the majority have concealed from the plaintiff "the financial affairs and books of the corporation" will excuse a lack of that precision which would ordinarily be demanded by the rules of good pleading.³

§ 1181. **Allegations as to Extent of Damage to Plaintiff.** — The extent of the damage to the plaintiff is irrelevant. Hence, allegations as to the depreciation in value of plaintiff's shares in consequence of the wrongs to the company on account of which the bill is filed may be stricken out as impertinent.⁴

§ 1182. **Multifarious Misjoinder of Claims.** — As a shareholder's bill is filed in the right of the corporation, it would seem clear that the joinder of any individual claim of the plaintiff against the company — as, for example, a claim for wrongfully withholding a dividend — would render the proceeding multifarious.⁵ Thus, an attempt to unite in one bill a claim by a

¹ *Woodroof v. Howes*, 88 Cal. 184; 26 Pac. 111; *Edwards v. Mercantile Trust Co.*, 124 Fed. 381.

But see *Mosher v. Sinnott*, 79 Pac. (Colo.) 742; *Macon, etc. R. R. Co. v. Shailer*, 141 Fed. 585, 588, 591; 72 C. C. A. 631 (ruling on fifth assignment of error).

² *Mosher v. Sinnott*, 79 Pac. (Colo.) 742.

³ *Blair v. Telegram Newspaper Co.*, 172 Mass. 201; 51 N. E. 1080.

⁴ *Kavanaugh v. Commonwealth Trust Co.*, 181 N. Y. 121.

⁵ *Searles v. Gebbie*, 115 N. Y. App. Div. 778.

Cf. *Edwards v. National Window Glass, etc. Ass'n* (N. J.), 58 Atl. 527; *Pietsch v. Krause*, 93 N. W. 9; 116 Wisc. 344; *Raynolds v. Diamond Mills Paper Co.* (N. J.), 60 Atl. 941 (headnote inadequate); *Metcalf v.*

American School Furniture Co., 108 Fed. 909 (claim to set aside illegal transfer of property by corporation improperly joined with claim for treble damages under the anti-trust act); *Morse v. Bay State Gas Co.*, 91 Fed. 944; *McCrea v. McClenahan*, 114 N. Y. App. Div. 70; *Brown v. Utopia Land Co.*, 103 N. Y. Supp. 50.

But see *Jones v. Missouri Electric Co.*, 144 Fed. 765; 75 C. C. A. 631. Cf. *Young v. Equitable Life Ass. Soc.*, 112 N. Y. App. Div. 760 (bill founded on a right of the corporation, an insurance company, not multifarious though plaintiff shows an interest both as stockholder and policy-holder); *Ætna Ins. Co. v. Albany, etc. R. Co.*, 156 Fed. 132 (bill by a shareholder in a lessor railway company against a lessee company to recover rental reserved

shareholder to cancel some of his shares as invalid and thus to relieve him of the burdens of ownership in respect thereof and a claim on behalf of all the shareholders that an entire issue of shares be declared void renders the bill multifarious.¹ But where the plaintiff shareholder complains that an officer of the company who owned a majority of its shares has mismanaged the corporation and fraudulently refused to declare or pay dividends to the minority, one suit may be brought to compel him to pay over to the company the moneys owing to it from him and to require the company to divide them among the minority shareholders as profits wrongfully withheld.² Of course, a shareholder's bill in the right of the company cannot be united in one suit with a claim for breach of a contract between the plaintiff and an individual defendant.³ Moreover, a shareholder's bill which complains of two separate wrongs, or breaches of contract, committed by different persons is multifarious even though in both instances relief is sought in the right of the company.⁴

§ 1183. **Defences to Suit.** — As every shareholder's bill is filed in the right of the company, any defence may be set up that would have been available had an action been brought in the name of the corporation. For instance, a shareholder cannot maintain a bill to set aside a judgment which is binding on the company.⁵ Moreover, where pending a shareholder's suit a bill is filed by the corporation based upon the same transaction, a final decree in the second suit either against or in favor of the company is a bar to the further maintenance of the shareholder's suit.⁶ For the same reason, where the company would be barred by limitations or laches, a shareholder's bill cannot be sustained;⁷

to the lessor corporation and also dividends agreed to be paid by the lessee to the several shareholders of the lessor held not multifarious).

¹ *Church v. Citizens St. R. Co.*, 78 Fed. 526.

² *Dunphy v. Traveller Newspaper Co.*, 146 Mass. 495; 16 N. E. 426.

³ *Stoddard v. Bell & Co.*, 100 N. Y. App. Div. 389; 91 N. Y. Supp. 477.

⁴ *Case v. New York Mutual Savings, etc. Ass'n*, 88 N. Y. App. Div. 538; 85 N. Y. Supp. 104; *Winsor v. Bailey*, 55 N. H. 218.

⁵ *Hendrickson v. Bradley*, 85 Fed. 508; 29 C. C. A. 303.

⁶ *Memphis, etc. R. R. Co. v. Grayson*, 88 Ala. 572; 7 So. 122; 16 Am. St. Rep. 69.

⁷ *Erny v. G. W. Schmidt Co.*, 197 Pa. St. 475; 47 Atl. 877.

and this is true, as to the defence of the statute of limitations, although the company may have been in control of the guilty parties so that a shareholder's bill was the only practicable remedy.¹ But limitations must be computed as of the date of the filing of the shareholder's bill. Thus, where a shareholder's suit is brought by one shareholder on behalf of himself and all others the shareholders in the company, the defendants cannot maintain the defence of limitations against shareholders who subsequently come in as plaintiffs unless the statute had run when the original bill was filed.² Lapse of time after commencement of the suit will not bar the right of shareholders to come in and take part in the control of the litigation.

§ 1184-§ 1187. *Effect of Decision on Shareholder's Bill.*

§ 1184. **Conclusiveness of Decision.** — The effect of a decision on the merits upon a shareholder's suit is to conclude both the corporation and all of its shareholders, and to prevent the questions involved from being reopened in any subsequent suit by other shareholders³ or otherwise, although a dismissal of the bill because no sufficient demand by the plaintiff upon the corporation had been proved will not bar another suit.⁴ So, where a shareholder's suit to enjoin an alleged fraudulent call is compromised and settled, the validity of the call cannot be challenged by the same shareholder in any subsequent proceeding.⁵ Moreover, as to every question actually raised and decided in a shareholder's suit, the decree is conclusive by way of estoppel in any suit subsequently instituted by another shareholder on account of other similar transactions.⁶ Upon the same underlying principle it would seem clear that when one shareholder's suit has been brought in which all the shareholders are invited to join, no other shareholder's bill can be filed on

¹ *Pietsch v. Milbrath*, 101 N. W. 388; 102 N. W. 342 (headnote inadequate). Cf. *infra*, § 1189.

² *Brinkerhoff v. Bostwick*, 99 N. Y. 185; 1 N. E. 663.

³ *Hearst v. Putnam Mining Co.* (Utah), 77 Pac. 753; 28 Utah 184; 107 Am. St. Rep. 698; 66 L. R. A. 784.

⁴ *The Telegraph v. Lee*, 98 N. W. 364; 125 Iowa 17.

⁵ *Oglesby v. Attrill*, 105 U. S. 605 (headnote inadequate).

⁶ *Willoughby v. Chicago Junction Rys. & Co.*, 50 N. J. Eq. 656; 25 Atl. 277.

account of the same transaction during the pendency of the other suit.¹

§ 1185. **Disposition of Money recovered as Result of Suit.** — If, as a result of the suit, money is recovered for the benefit of the company, it goes into the corporate treasury as any other funds of the company, and enures to the benefit of all shareholders, — those assenting to the suit and those dissenting from it, those innocent and those guilty.² Although this may seem to outrage one's sense of propriety, yet in no other way can legal principle be satisfied, and upon the whole in no other way can so near an approach to perfect justice be attained. In such a case, however, where the money is eventually to be distributed among the shareholders, the court may order immediate payment to the plaintiff of his share or proportion;³ but of course this should not ordinarily be done unless the corporation has been dissolved.⁴

§ 1186. **Counsel Fees.** — If the shareholder is successful in maintaining his bill and recovers a sum of money for the benefit of the corporation, his reasonable counsel fees may be allowed out of the amount recovered.⁵ Moreover, the amount of such

¹ *Dannmeyer v. Coleman*, 11 Fed. 97, 104 (semble).

Cf. *Dady v. Georgia, etc. Ry. Co.*, 112 Fed. 838.

Aliter where the first suit was in a state court and the second in a federal court: *Consumers' Gas Trust v. Quinby*, 137 Fed. 882; 70 C. C. A. 220.

² *Barry v. Moeller*, 59 Atl. (N. J.) 97, 99; *Landis v. Sea Isle, etc. Co.*, 53 N. J. Eq. 654; 33 Atl. 964; *Wallace v. Lincoln Savings Bank*, 89 Tenn. 630, 635; 15 S. W. 448; 24 Am. St. Rep. 625 (semble); *Zinn v. Baxter*, 65 Oh. St. 341; 62 N. E. 327; *Rafferty v. Donnelly*, 197 Pa. St. 423, 429; 47 Atl. 202 (semble).

Cf. *Loewenstein v. Diamond Soda Water Co.*, 94 N. Y. App. Div. 383; 88 N. Y. Supp. 313 (holding that the plaintiff in a shareholder's bill cannot recover his individual damages for diminution in the value of his shares); *Chicago Macaroni, etc. Co. v. Boggiano*, 202 Ill. 312; 67

N. E. 17; *Von Arnim v. American Tube Works*, 188 Mass. 515, 519 (headnote inadequate); 74 N. E. 680; *Peck v. Peck*, 33 Colo. 421; 80 Pac. 1063.

But see contra: *Brown v. De Young*, 167 Ill. 549; 47 N. E. 863; *Spaulding v. North Milwaukee Town Site Co.*, 106 Wisc. 481; 81 N. W. 1064; *Adams v. Burke*, 201 Ill. 395; 66 N. E. 235.

³ *Eaton v. Robinson*, 19 R. I. 146; 31 Atl. 1058; 32 Atl. 339; 29 L. R. A. 100.

Cf. *Brown v. De Young*, 167 Ill. 549; 47 N. E. 863.

But see *Landis v. Sea Isle, etc. Co.*, 53 N. J. Eq. 654; 33 Atl. 964.

⁴ *McCrea v. McClenahan*, 114 N. Y. App. Div. 70.

⁵ *Louisville Bridge Co. v. Dodd*, 85 S. W. 683; 27 Ky. Law Rep. 454; *Lillard v. Oil Paint, etc. Co.* (N. J.), 58 Atl. 188 (where complainant having been only partially successful was allowed only a part of his

fees, proportioned to the value of the services rendered, may be fixed by the court as an incident to the shareholder's suit without requiring an original proceeding to be instituted.¹ On the other hand, where the complainant shareholder succeeds merely in restraining the commission of an *ultra vires* or otherwise wrongful act, he cannot have a decree against the company for the amount of his counsel fees.² *A fortiori*, if the complaining shareholder is unsuccessful in his suit, his counsel cannot recover their fees from the corporation.³ But although the recovery against the company is thus contingent, the fee must not be estimated according to the liberal scale ordinarily permissible in the case of contingent fees, and certainly no agreement that the complaining shareholder may have made with his counsel for the payment of a certain percentage on the amount recovered will control the court in fixing the amount of the allowance.⁴

It has been held that the expense of unsuccessfully defending a shareholder's bill cannot be charged against the company.⁵

§ 1187. **Liability of Plaintiffs for Costs.** — Although if the corporation were the plaintiff any liability for costs and expenses would fall upon it and would ultimately be borne by the shareholders in proportion to their holdings, yet where a bill is filed by several shareholders founded upon a right of the company, the plaintiffs are, like other co-plaintiffs, liable for costs *per capita* and not *pro rata* according to the number of shares held by each.⁶ If the suit were prosecuted to final decree, the chancellor in the exercise of his ordinary discretion with respect to

counsel fee); *Meeker v. Winthrop Iron Co.*, 17 Fed. 48; *Forrester v. Boston, etc. Mining Co.*, 29 Mont. 397; 74 Pac. 1088; 76 Pac. 211; *McCourt v. Singers-Bigger*, 145 Fed. 103; *Davis v. Gemmell*, 73 Md. 530; 21 Atl. 712.

¹ *Louisville Bridge Co. v. Dodd*, 85 S. W. 683; 27 Ky. Law Rep. 454; *Forrester v. Boston, etc. Mining Co.*, 29 Mont. 397; 74 Pac. 1088; 76 Pac. 211.

² *Alexander v. Atlanta, etc. R. R. Co.*, 113 Ga. 193.

³ *Graham v. Dubuque Specialty, etc. Works* (Iowa), 114 N. W. 619 (semble).

⁴ *Graham v. Dubuque Specialty, etc. Works* (Iowa), 114 N. W. 619.

⁵ *McConnell v. Combination Mining, etc. Co.*, 30 Mont. 239; 76 Pac. 194; 104 Am. St. Rep. 703; 31 Mont. 563, 572; 79 Pac. 248; *McCourt v. Singers-Bigger*, 145 Fed. 103; 76 C. C. A. 73.

⁶ *Edwards v. Bay State Gas Co.*, 130 Fed. 242.

costs might doubtless adjust the costs in such a way as to distribute any burden cast upon the complaining shareholders *pro rata* in proportion to their shares rather than *per capita*.

§ 1188. **Intervention by a Shareholder in pending Suit by or against the Company.** — Generally the shareholder's intervention in the corporate management, where permissible, must necessarily be by original bill;¹ but where a suit in equity (or, under the loose statutory practice prevailing in some states, any legal proceeding) is already pending by or against the corporation and about to be prosecuted to decree, a shareholder's proper course, if those in control of the company decline to prosecute or defend the suit, as the case may be, either fraudulently or by such supine negligence as to be equivalent to fraud, is to file an intervening petition praying to be made a party defendant and allowed to present in his own name the company's case.²

¹ Cf. *Urner v. Sollenberger*, 86 Md. 316; 43 Atl. 810 (where a shareholder who was defendant in an action at law attempted, unsuccessfully, to avail of facts which would have justified an independent shareholder's bill); *Dimock v. Central Rawdon Mining Co.*, 36 Nova Scotia 337 (as to the shareholders' remedy against a collusive judgment against the corporation); *Land, Log & Lumber Co. v. McIntyre*, 100 Wis. 245, 246 (explaining that the shareholder's remedy is always in equity even where the only remedy of the corporation would have been at law).

² *Bronson v. LaCrosse, etc. R. R. Co.*, 2 Wall. 283; *Fitzwater v. Nat. Bank of Seneca*, 62 Kans. 163; 61 Pac. 684; *State ex rel. Bugbee v. Holmes*, 60 Nebr. 40; *Majors v. Taussig*, 20 Colo. 44 (where the court adopted under the Colorado Code a liberal construction of the intervening petition in order to sustain the right of intervention).

Cf. *General Electric Co. v. West*

Asheville Imp. Co., 73 Fed. 386; *Hamlin v. Toledo, etc. R. R. Co.*, 78 Fed. 664; 24 C. C. A. 271; 36 L. R. A. 826 (where preferred shareholders having no voting rights were allowed to intervene because of their peculiarly helpless position); *Gunderson v. Illinois Trust, etc. Bank*, 199 Ill. 422; 65 N. E. 326 (where a shareholder's petition for leave to intervene in a foreclosure suit was denied); *Land Title, etc. Co. v. Asphalt Co.*, 127 Fed. 1; 62 C. C. A. 23 (where leave to intervene was refused); *Meyer v. Bristol Hotel Co.*, 163 Mo. 59, 68-69; 63 S. W. 96 (where leave to intervene was denied); *Central Trust Co. v. Washington Co. R. R. Co.*, 124 Fed. 813; *Bond v. Gray Improvement Co.*, 102 Md. 426; 62 Atl. 827 (shareholder no standing to except to ratification of foreclosure sale of company's property); *Ex parte Cutting*, 94 U. S. 14, 22 (where the court said that a shareholder's application for leave to intervene "is always ad-

The court in such a case ought not to authorize the shareholder to answer in the name of the company; but if the court should do so, the answer filed in pursuance of such authority will not be a mere nullity, but will be treated on appeal, as a matter of grace rather than of right, as if it were the individual answer of the shareholder.¹ So, if the company after bringing a suit in the corporate name passes into the control of the wrongdoers who are about to abandon the suit, a minority shareholder may be allowed to intervene.² A person who denies that he is a shareholder, but who alleges that according to a judicial decision rendered in another case he has been determined to be shareholder, cannot have the right to intervene to protect the interests of the company.³ Speaking in general terms, one may safely say that the right of intervention will be granted only when such facts are shown as would support an independent shareholder's bill.⁴ Thus, where both the corporation and a shareholder are parties to a suit in equity, the shareholder cannot plead the defence of limitations to a claim against the corporation where

dressed to the sound judicial discretion which cannot be controlled by mandamus").

But see *Central Trust Co. v. Marietta, etc. R. R. Co.*, 48 Fed. 14.

As to what objections the intervening shareholder may be precluded from raising, see *Citizens, etc. Trust Co. v. Union Mining, etc. Co.*, 106 Fed. 97.

¹ *Bronson v. LaCrosse, etc. R. R. Co.*, 2 Wall. 283, 303 (headnote inadequate).

² *Ainsworth v. Evans (Ariz.)*, 80 Pac. 344; *Eagle Iron Co. v. Colyar*, 156 Fed. 954 (where on dismissal of the suit brought in the corporate name, the dissenting shareholders were permitted to file a supplemental bill in their own names).

Cf. *Gray v. South & North R. R. Co. (Ala.)*, 43 So. 859 (where a suit in equity having been instituted in the corporate name in response to a shareholder's demand, the shareholder sought in vain to maintain a suit in his own name in a court of

concurrent jurisdiction on the ground that the corporation was not prosecuting the first suit earnestly).

³ *Meyer v. Bristol Hotel Co.*, 163 Mo. 59; 63 S. W. 96.

⁴ *Ainsworth v. Evans (Ariz.)*, 80 Pac. 344; *Park v. Petroleum Co.*, 25 W. Va. 108 (where the would-be intervenor owned a majority of the shares); *Majors v. Taussig*, 20 Colo. 44 (semble).

Cf. *Frederick Milling Co. v. Frederick, etc. Co. (S. Dak.)*, 106 N. W. 298 (where a shareholder was allowed to intervene to set aside a judgment by confession of the president without making any demand upon the corporation itself to raise the objection, there being no board of directors capable of being convened); *Hobbs v. Dane Mfg. Co.*, 5 Allen (Mass.) 581 (holding that a shareholder who is made party to an action to recover a corporate debt, the shareholders being subject to a statutory liability, cannot in his own name raise defences which would be available to the corporation).

the company neglects or refuses to do so.¹ But if the intervening petition sets out a good defence to the suit which the directors have failed to present, although there be no allegation that the directors have refused on request to set it up, the court may, it seems, allow the petitioners an opportunity to apply to the board of directors.²

The shareholder's right of intervention must ordinarily be exercised in the court of first instance; and at all events a shareholder cannot prosecute an appeal from a decree against the corporation.³ When the shareholder intervenes he can present such defences only as would be available to the corporation.⁴

The remedy by intervention, where it exists, is exclusive, and prevents any remedy by original bill.⁵

§ 1189. **Failure of Shareholders to file Bill for Injury to Corporation not imputable to Company as Laches.**— Individual shareholders may, as shown above, be barred by laches from filing a shareholder's bill to complain of *ultra vires* or fraudulent transactions on the part of the directors; but their failure to file a shareholder's bill or to intervene in a pending equity case, where such intervention is the appropriate channel to relief, cannot be reckoned to the corporation so as to preclude it, when the control has been wrested from the guilty parties, from obtaining suitable relief. That no individual shareholder felt called upon to assume, as he might have done, the burden of litigation which properly belonged to the corporation cannot be accounted laches of the company, and of course the failure of the company to object while in the control of the guilty parties cannot be deemed laches. Thus, where the directors fraudulently refuse to set up any defence to a foreclosure suit brought against the company, the fact that the shareholders, who had knowledge of the directors' misconduct and who in fact requested them to resign and let others be chosen, failed to

¹ *Davis v. Gemmell*, 73 Md. 530;
21 Atl. 712.

² *Farmers' L. & T. Co. v. Toledo & Ry. Co.*, 67 Fed. 49, 53 (semble).

³ *State v. Florida Central R. R. Co.*, 15 Fla. 690, 725-726; *Ex parte Cutting*, 94 U. S. 14.

⁴ *Big Creek, etc. Iron Co. v. American L. & T. Co.*, 127 Fed. 625; 62 C. C. A. 351.

⁵ Cf. *Waymire v. San Francisco, etc. Ry. Co.*, 112 Cal. 646; *Gray v. South & North Ry. Co. (Ala.)*, 43 So. 859 (stated supra, p. 985, n. 2).

intervene, as they might have done, and defend the suit on behalf of the company, cannot prevent the corporation from filing a bill to set aside the foreclosure decree, as soon as the terms of the unfaithful directors expire and honest successors are chosen to the office.¹

¹ *Pacific R. R. Co. v. Missouri Pac. Ry. Co.*, 111 U. S. 505; 4 Sup. Ct. 583. Cf. *supra*, § 1183.

CHAPTER XXI

SHAREHOLDERS' MEETINGS

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§ 1190. **Importance of General Meeting — Value of Right to Vote.** — While the directors represent the company for many purposes, yet the ultimate authority in any corporation resides in the shareholders or members; and a shareholders' meeting, or general meeting of the company,¹ constitutes the court of last resort in corporate affairs. The right to vote at such a meeting often constitutes the only element of value in a company's shares. The corporation may be overcapitalized, and its shares may represent mere water. The payment of interest on the company's bonds or debentures may be so heavy a charge that the possibility of profits more than sufficient to defray these necessary expenses may be too remote for practical consideration; and moreover even if such profits should be earned they might be eaten up by the payment of interest on income bonds or dividends on preferred shares (unless the profits were much greater than could possibly be anticipated). So far as any probability of direct pecuniary return is concerned, the shares may be worthless; and yet they may have a considerable market value by reason of the control which the ownership of them gives over the management and policies of the company. As this control can

¹ As to the meaning of the expression "general meeting," see *Mutual Fire Ins. Co. v. Farquhar*, 86 Md. 668, 671-672; 39 Atl. 527.

only be exercised through the medium of a shareholders' meeting, the method of convening such a meeting, and the manner of conducting the proceedings thereat are of great and indeed fundamental importance in the management of corporations.

§ 1191. **Powers of General Meeting — Control over Directors.** — The extent of the control which a general meeting may exercise over the directors, and the power of the shareholders to take the management of the company away from the directors into their own hands is considered below.¹ In general, it is submitted that a statute expressly conferring certain powers on the directors ought not to be construed as denying them to the shareholders unless they are such as without express authority the corporation would not have possessed;² but many excellent authorities hold the contrary.³ Of course, where some extraor-

¹ *Infra*, § 1440, § 1441.

See also *Garmany v. Lawton*, 124 Ga. 876; 53 S. E. 669; 110 Am. St. Rep. 207; *Aransas Pass, etc. Co. v. Manning*, 63 S. W. 627 (headnote inadequate); 94 Tex. 558.

² *Kirwin v. Washington Match Co.*, 79 Pac. 928; 37 Wash. 285.

Said Brewer, J., in *Chicago, etc. Ry. Co. v. Union Pac. Ry. Co.*, 47 Fed. 15, 19: "In this, as in any other stock corporation, with the stockholders rests not only the ownership of the property, but the ultimate and absolute power and control. . . . Any act although within the powers of the board of directors, when done by an executive officer, with the direction or approval of the stockholders, is binding on the corporation, although the directors have never adopted or approved of it, unless by the terms of the charter exclusive power therefor is vested in the directors." This decision was afterwards affirmed in the Supreme Court. *Union Pac. Ry. Co. v. Chicago, etc. Ry. Co.*, 163 U. S. 564; 16 Sup. Ct. 1173.

Cf. *Griffing Iron Co.*, 63 N. J. Law 168, 172 (headnote inadequate); 41 Atl. 931; *Cunningham v. German Ins. Bank*, 101 Fed. 977, 980; 41 C. C. A. 609 ("In so far as the duties

of the directors are not expressly prescribed by the charter, they derive their powers from the stockholders, who may, if they see fit, select other agencies for the transaction of the corporate business.").

³ *Automatic Self Cleansing Filter Syndicate Co. v. Cunningham* (1906), 2 Ch. 34; *People v. Sterling Mfg. Co.*, 82 Ill. 457, 461 (semble); *McCullough v. Moss*, 5 Denio (N. Y.) 567, 575; *St. Helen Mill Co.*, 3 Sawy. 88; *Walsenburg Water Co. v. Moore*, 5 Colo. App. 144; 38 Pac. 60; *Insurance Bank v. Bank of U. S.*, 4 Clark (Pa.) 125; *Granger v. Grubb*, 7 Phila. (Pa.) 350; *Colorado Springs Co. v. American Pub. Co.*, 97 Fed. 843, 853; 38 C. C. A. 433 (where the court conceded that a shareholders' meeting would possess the same powers as the directors if all the shareholders were in attendance); *Læwenenthal v. Rubber Reclaiming Co.*, 52 N. J. Eq. 440, 445-446; 28 Atl. 454 (where the court said, "The stockholders, as such, have no power to make any contract or execute any work. Their power is confined to electing directors and advising them in the conduct of the business of the company"); *Dunsmuir v. Colonist Printing & Pub. Co.*, 9 Brit. Columb. 290; *Great Central*

dinary power which would not otherwise be exercisable by the corporation is specially conferred upon the directors, it cannot be exercised by the shareholders, since it was not in terms intrusted to them, and since a special power must be strictly pursued. But even in that case, if all the shareholders are directors, their action would not be vitiated because they purported to act in their capacity of shareholders rather than in that of directors;¹ and even if some shareholders were not directors, it would seem, on principle, that if all the directors are present at the meeting of shareholders and concur in the action there taken, such action would be equivalent to formal action of the directors at a board meeting.² If a statute authorizes a mortgage to be made by the directors, but only with the consent of two thirds of the shareholders, that is an implied negation of any power in the shareholders alone to mortgage the property.³ Moreover, the shareholders cannot exercise any powers which the company's incorporation paper expressly declares shall be vested exclusively in the directors.⁴

§ 1192. **Delegation of Powers to Directors or Agents.** — Whether a shareholders' meeting may delegate to the directors or other agents any powers which by the constitution of the company are reposed in the shareholders themselves, that is to say, in the corporation at large, may be perhaps open to debate. Judge Story in an early case, applying the maxim *delegata potestas non potest delegari*, expressed a rather tentative opinion that no such delegation of powers from the shareholders to the directors would be valid.⁵ This dictum was based on the

Freehold Mines v. Brandon, 30 Vict. L. R. 97 (stated *infra*. § 1192, n. 4); *Isle of Wight Ry. Co. v. Tahourdin*, 25 Ch. D. 320 (per Kay, J., reversed on appeal).

¹ *People v. Sterling Mfg. Co.*, 82 Ill. 457. Cf. *Manufacturers' Exhibition Bldg. Co. v. Landay*, 76 N. E. 146; 219 Ill. 168.

² Cf. *infra*, § 1465.

But see *Gashwiler v. Willis*, 33 Cal. 11; *Cammeyer v. United German Lutheran Churches*, 2 Sandf. Ch. (N. Y.) 186, 228-230.

³ *Curtin v. Salmon River, etc. Co.*, 130 Cal. 345; 62 Pac. 552; 80 Am. St. Rep. 132.

⁴ *Union Trust Co. v. Carter*, 139 Fed. 717.

Cf. *Automatic Self-Cleansing Filter Syndicate v. Cunninghame* (1906), 2 Ch. 34.

⁵ *Ex parte Winsor*, 3 Story, 411. The point actually decided was that a by-law authorizing the directors "to take care of the interests and manage the concerns of the corporation" would not amount to a delegation of powers specially reposed in the shareholders by statute, — a conclusion with which no one would be disposed to quarrel. As to this case see also *infra*, § 1443.

ancient notion that the powers of a corporation are delegated to it by the state; and inasmuch as according to modern conceptions the powers of an ordinary incorporated company are derived from the shareholders themselves, and are not delegated from any outside source, it is submitted that Judge Story's dictum ought not to be, and probably would not be, followed. Indeed, an Alabama case, although attempting to distinguish Judge Story's dictum, would seem to be inconsistent with it.¹

§ 1193-§ 1210. *HOW MEETING MAY BE CALLED.*

§ 1193. **In general — Power of Shareholders.** — In view of the extensive powers of a general meeting, reason would seem to demand that some way of convening such an assembly should be open to the shareholders even when none is distinctly given by statute, charter, or the regulations of the company.² Indeed, it would seem on principle that any affirmative provision prescribing a mode in which a general meeting may be called should be taken to be directory merely, and not to exclude any other method that would otherwise have been available.³ But although this seems reasonable enough, yet a different opinion seems to have been approved in an English case where it was said that, if a company's regulations provide a mode by which one fifth of the shareholders may call a general meeting, no smaller number can in any way do so;⁴ and several American cases seem to be in accord with this doctrine.⁵ Thus, where the regulations of a

¹ *Rives v. Montgomery South Plank-Road Co.*, 30 Ala. 92.

² See argument in *Lord v. Governor, etc. Copper Mines*, 2 Phillips Ch. 740, 748.

Cf. *People v. Twaddell*, 18 Hun (N. Y.), 427; *Toronto Brewing Co. v. Blake*, 2 Ont. 175, 184; *Chamberlain v. Painesville, etc. R. R. Co.*, 15 Oh. St. 225, 250.

³ *Foss v. Harbottle*, 2 Hare 461 (semble); *Citizens' Mut. Fire Ins. Co. v. Sortwell*, 8 Allen (Mass.), 217.

Cf. *Borland's Trustee v. Steel Brothers & Co.* (1901), 1 Ch. 279, 293 (headnote inadequate); *Sovereen, etc. Co. v. Whitside*, 12 Ont.

L. R. 638, 643 (semble); *Brick & Stone Co.*, W. N. (1878), 140 (where there were no directors).

⁴ *Macdougall v. Gardiner*, 10 Ch. 606.

⁵ Cf. *Southern Plank Road Co. v. Hixon*, 5 Ind. 165; *Congregational Society of Bethany v. Sperry*, 10 Conn. 200; *State v. Pettineli*, 10 Nevada 141 (holding that the president has no inherent power to call a general meeting).

But it has been held that in the absence of express regulation as to the calling of general meetings the "general agent" of a manufacturing company has implied power to con-

bank provide that meetings of the shareholders may be called by the board of directors or by any three shareholders, a meeting called by the president and the cashier is irregular.¹ The objection to this view, by which such provisions are held to be mandatory, and by which a common-law right of a shareholder to summon a meeting is denied, is that if for any reason the prescribed method of calling a meeting becomes impossible, the company's active existence must almost necessarily come to an end.² At all events, the existing authorities do not disclose how a shareholder's common-law right (if any such he have) to convene a general meeting is to be exercised.

§ 1194. **Power of Courts to convene Meetings.** — A court of equity has ample jurisdiction to direct and compel a shareholders' meeting to be convened whenever justice demands.³ To be sure, in one case the court declared that equity would not convene a general meeting where neither the directors nor one fifth of the shareholders, in whom under the company's articles the power of calling a meeting was vested, were willing to do so;⁴ but this general language of the court should, it is submitted, be taken in connection with the particular facts of the case, which were not such as to necessitate or justify that mode of relief. Moreover, the English courts of equity have repeatedly directed general meetings to be held for the purpose of determining whether a legal proceeding begun in the company's name has the approval of the shareholders;⁵ and no reason is perceived why the same power should not be exercised in any other case where justice can best be done in that way. At any meeting so convened by judicial authority, however, the voting rights of the shareholders must be governed by the company's constitution;⁶ and the court has no power for any reason to order a meeting at which shareholders may vote who are incompetent under the company's articles

vene them, *Stebbins v. Merritt*, 10 Cush. (Mass.) 27. Cf. *Toronto Brewing Co. v. Blake*, 2 Ont. 175, 184.

¹ *Matthews v. Columbia Nat. Bank*, 79 Fed. 558.

² *Goulding v. Clark*, 34 N. H. 148.

³ See *Lehigh Coal, etc. Co. v. Central R. R. Co.*, 35 N. J. Eq. 349; *Forsyth v. Brown*, 33 Wkly. Notes Cas. (Pa.) 72, 74 (headnote inadequate); *Bartlett v. Gates*, 118 Fed. 66.

As to the control of courts of equity over shareholders' meetings, see also *infra*, § 1280-§ 1284.

⁴ *Macdougall v. Gardiner*, 10 Ch. 606.

⁵ *Supra*, § 1141.

⁶ As to enjoining particular shareholders from voting, see *infra*, § 1284.

of association,¹ nor to order a meeting at which shareholders who have been guilty of fraud shall not be allowed to vote.²

Where the directors or officers wrongfully refuse to summon a meeting at the time appointed by the regulations, a court of law will issue a mandamus on the relation of any shareholder to compel them to do so.³

§ 1195. **Call for Meeting by Directors.**—The usual method of convening a general meeting is undoubtedly by call of the board of directors. And it is submitted that the directors have an inherent power of calling such a meeting without express authorization.⁴ Where the directors' meeting which issued the call for a general meeting was itself summoned on an unreasonably short notice, the shareholders' meeting there summoned is nevertheless a legal general meeting.⁵ Moreover, if two directors are invested with authority to call a shareholders' meeting, summons by a *de facto* director afterwards ratified by another director will have the effect of convening a legal meeting;⁶ and in general a meeting convened by *de facto* directors is as valid as if they were directors *de jure*.⁷

¹ *Anglo-Universal Bank v. Bar-agnon*, 45 L. T. 362.

Cf. *Cannon v. Trask*, 20 Eq. 669.

² *Mason v. Harris*, 11 Ch. D. 97.

³ *Regina v. Aldham*, 15 Jur. 1035; *State v. Wright*, 10 Nevada 167; *People v. Cummings*, 72 N. Y. 433; *People v. Albany Hospital*, 61 Barb. (N. Y.) 397; *Bassett v. Atwater*, 65 Conn. 355; 32 Atl. 937; 32 L. R. A. 575; *Mottu v. Primrose*, 23 Md. 482.

Cf. *Sylvania, etc. R. Co. v. Hoge* (Ga.), 59 S. E. 806 (holding that where no election of directors is had at the stated annual meeting, the directors holding over may be compelled by mandamus to summon another meeting for the purpose of electing their successors).

⁴ *Citizens Mutual Fire Ins. Co. v. Sortwell*, 8 Allen (Mass.) 217.

⁵ *Browne v. La Trinidad*, 37 Ch. D. 1.

But see contra: *Johnston v. Jones*, 23 N. J. Eq. 216, 227–228.

Cf. *Southern Counties Deposit Bank v. Rider*, 73 L. T. 374; s. c.,

sub nom. *Southern Counties Deposit Bank v. Kirkwood*, 11 Times L. R.

563 (where the directors' meeting that issued the summons was not attended by a quorum, and yet the shareholders' meeting was held valid); *State of Wyoming Syndicate* (1901), 2 Ch. 431 (shareholders' meeting convened by secretary instead of by directors held void); *Haycraft Gold Reduction, etc. Co.* (1900), 2 Ch. 230 (headnote inadequate — meeting convened on order of directors severally without a board meeting held void).

⁶ *Transport, Ltd. v. Schonberg*, 21 Times L. R. 305.

⁷ *Commonwealth ex rel. Jackson v. Smith*, 45 Pa. St. 59; *Boschoek Proprietary Co. v. Fuke* (1906), 1 Ch. 148 (where the number of acting directors had fallen below the minimum, and where some of those who were acting were disqualified); *St. Nicholas Greek Catholic Society*, 29 Pa. Co. Ct. 193.

§ 1196. **Regulations requiring Directors to convene Meeting upon Request and permitting Requisitionists to call the Meeting upon Non-compliance with this Request.**— Sometimes it is provided that a certain number of shareholders may request the directors to call an extraordinary general meeting, and that, in case of their refusal to do so, the shareholders may call the meeting themselves. When such a request is presented, the directors should not undertake to determine whether the objects for which the meeting is asked are *ultra vires* or illegal, but should convene the meeting as requested.¹ If the directors in summoning the meeting omit from the statement of the business to be transacted some of the objects which the requisitionists had demanded should be inserted, the latter may treat such action as a refusal of their requisition, and proceed to call a meeting themselves.² Under such a provision, it would seem that a request to *de facto* directors is as effective as if they were legitimate occupants of the office.³

§ 1197. **Revocation of Call convening Meeting.**— The same authority that may summon a general meeting does not necessarily have power to revoke the call, or to postpone the meeting. Thus, authority of the directors to convene a general meeting, does not imply authority to postpone a meeting after it has once been called and before it has actually convened.⁴

§ 1198-§ 1210. NOTICE TO SHAREHOLDERS OF MEETING.

§ 1198. **Necessity for Notice in general.**— Unless the time and place of meeting are fixed by the company's regulations, some reasonable notice of the meeting, whether called by the directors or other lawful authority, must be given to the several shareholders.⁵ But no notice is required of a meeting the precise

¹ Cf. *Hooper v. Kerr, Stuart & Co.*, 83 L. T. 729 (where the secretary on receipt of the requisition proceeded to issue a notice of meeting without authority from the directors, by whom, however, his action was subsequently ratified); *Isle of Wight Ry. Co. v. Tahourdin*, 25 Ch. D. 320.

² *Foss v. Harbottle*, 2 Hare, 461 (as to which see *infra*, § 1482).

As to the case where the number of directors has been reduced by casual vacancies below a competent quorum, see *Sovereign, etc. Co. v. Whitside*, 12 Ont. L. R. 638, 643 (semble).

⁴ *Smith v. Paringa Mines* (1906), 2 Ch. 193.

⁵ *Isle of Wight Ry. Co. v. Tahourdin*, 25 Ch. D. 320.

⁵ *Smyth v. Darley*, 2 H. L. Cas. 789.

time and place of which are fixed by the company's charter, articles, by-laws,¹ or other regulations. Notice must be given not merely of the day but also of the hour and place of the meeting, and hence the necessity for notice is not dispensed with by a by-law fixing the day of the annual meeting but not its hour or place.² Probably, notice is not required for an adjourned meeting;³ but of course if a meeting is convened without due notice all adjournments thereof are irregular unless the several shareholders are notified of the adjourned meeting.⁴

If a stated meeting is for any reason not held at the appointed time, a minority of the shareholders cannot meet later in the day and adjourn until another time; and if they do so, such adjourned meeting would not be a legal meeting.⁵ But of course the meeting need not convene on the stroke of the clock: if it commences within a reasonable time the law is satisfied.⁶ And a meeting may continue a longer time than is permitted by the company's regulations, which will be construed in this respect as directory merely.⁷ But the meeting cannot legally organize before the hour named in the notice.⁸

¹ *People v. Albany, etc. R. R. Co.*, 55 Barb. (N. Y.) 344; *Jones v. Hilldale Cemetery Soc.* (Ky.), 65 S. W. 838; *New York Electrical Workers' Union v. Sullivan*, 107 N. Y. Supp. 886.

Cf. *Procter Coal Co. v. Finley*, 98 Ky. 405; 33 S. W. 188.

² *San Buenventura, etc. Co. v. Vassault*, 50 Cal. 534; *Cassell v. Lexington, etc. Co.*, 9 S. W. Rep. 701; 10 Ky. Law Rep. 486; *U. S. v. McKelden*, MacA. & Mack. (D. C.), 162; *Charter Gas Engine Co. v. Charter*, 47 Ill. App. 36, 54.

But see *People v. Twaddell*, 18 Hun (N. Y.) 426.

³ Cf. *People v. Batchelor*, 22 N. Y. 128; *Re Hammond*, 139 Fed. 898; *Callahan v. Chilcott Ditch Co.* (Colo.), 86 Pac. 123 (stated infra, p. 1007, n. 2).

As to irregular adjournment or organization of another meeting, see *Argus Printing Co.*, 1 N. Dak. 434; 48 N. W. 347; 26 Am. St. Rep. 639.

⁴ *U. S. v. McKelden*, MacA. & Mack. 405; 33 S. W. 188.

Mack. (D. C.), 162 (headnote inadequate).

⁵ *State v. Bonnell*, 35 Oh. St. 10.

But of course if a meeting is not held at the appointed time, it may be held subsequently if due notice be given, the provision as to the time of meeting being merely directory. *Beardsley v. Johnson*, 121 N. Y. 224 (headnote inadequate); 24 N. E. 380; *Hughes v. Parker*, 20 N. H. 58. See also infra, § 1213.

Cf. *Scanlan v. Snow*, 2 App. D. C. 137; *Pond v. Vermont, etc. R. R. Co.*, Fed. Cas. No. 11,264.

⁶ Cf. *South School Dist. v. Blakeslee*, 13 Conn. 227; *People v. Albany, etc. R. R. Co.*, 55 Barb. (N. Y.) 344, 358-59.

⁷ *Hussey v. Gallagher*, 61 Ga. 86, 91; *Mohawk & Hudson Ry. Co.*, 19 Wend. (N. Y.) 135, 147; *Rudolph v. So. Beneficial League*, 23 Abb. N. C. (N. Y.) 199; 7 N. Y. Supp. 135.

⁸ *People v. Albany, etc. R. R. Co.*, 55 Barb. (N. Y.) 344.

Cf. *Procter Coal Co. v. Finley*, 98

§ 1199. **Who must be notified.** — It seems that no notice need be given to a deceased member, or his estate, if the personal representative has not been registered as the holder of the shares;¹ and at all events notice posted to such deceased shareholder at his address is enough, even though the directors knew of his death,² and notwithstanding the fact that the administrator has written to the company upon paper bearing his own address.³ So, the notice is good although one of the shareholders to whom it is sent is a lunatic.⁴ Where shares are owned by a firm, notice to one of the partners is equivalent to notice to all.⁵ And ordinarily only the holders of legal title to shares would be entitled to notice, and therefore a mere pledgee would not be entitled thereto.⁶ But the mere fact that the notice is given to the beneficial owner instead of to a trustee holding the bare legal title will not invalidate the meeting.⁷ It has been said that only those members of the corporation who are within a reasonable distance and not abroad need be notified of the meeting;⁸ but it is at least doubtful whether in the United States the mere fact that a shareholder resides in another state would be an excuse for failure to give him due notice.⁹

§ 1200. **Form or Kind of Notice.** — In the present condition of the authorities it is difficult to say precisely what kind of notice is sufficient where no particular form is prescribed. Perhaps an irregularity in the formal notice will not invalidate the meeting if all the members have in fact full and fair notice.¹⁰ Written notice mailed a reasonable time before the date for the meeting to the last known address of each shareholder, one would have thought *a priori* would almost certainly be held sufficient.¹¹ Personal notice would probably always be

¹ *Allen v. Gold Reefs of West Africa* (1900), 1 Ch. 656 (semble).

² *Allen v. Gold Reefs of West Africa* (1900), 1 Ch. 656.

³ *Dana v. Am. Tobacco Co.* (N. J.), 65 Atl. 730, aff'd, 69 Atl. 223.

⁴ *Stebbins v. Merritt*, 10 Cush. (Mass.) 27.

⁵ *Kenton Furnace Co. v. McAlpin*, 5 Fed. 737, 748.

⁶ *McDaniels v. Flower Brook Co.*, 22 Vt. 274.

⁷ *American Nat. Bank v. Oriental Mills*, 17 R. I. 551; 23 Atl. 795.

⁸ *Smyth v. Darley*, 2 H. L. Cas. 789, 803. But see *Jenner Institute*

of Preventive Medicine, 15 Times L. R. 394 (where North, J., held

that notice must be given to members in India and Australia). Cf.

infra, § 1202.

⁹ Compare the similar point with respect to directors, *infra*, § 1451.

¹⁰ *People v. Peck*, 11 Wend. (N. Y.) 604 (headnote misleading);

27 Am. Dec. 104. But see *infra*,

§ 1201.

¹¹ But see *contra*: *Tuttle v.*

good.¹ Possibly, notice by publication in a newspaper published at the home office of the company would be good.² The notice must show on its face that it is given by competent authority.³ For this reason, a notice signed "O., Secretary," is bad, although in fact authorized by the number of shareholders who under the regulations were empowered to call the meeting.⁴ A misnomer of the corporation in the notice is not fatal if enough appears to identify the company.⁵ A publication of notice of the meeting, in addition to the notice required by the by-laws, is not improper.⁶ A single notice may serve to convene two successive meetings.⁷

§ 1201. **Regulations prescribing a particular Kind of Notice.**—Where the company's regulations require any particular kind of notice, the requirement must be observed.⁸ Thus, where the notice is required to be in writing, oral notice would be insufficient;⁹ and therefore parol evidence of notification is in such a case inadmissible unless the loss of a written notice has first been proved.¹⁰ So, where the regulations require either personal notice or notice through the public post, notice by advertisement in a newspaper would be insufficient. If the regulations require notice to be published in a newspaper circulating in a certain town, publication in a late edition of a newspaper, which edition never reached that town, is not sufficient.¹¹

Michigan, etc. R. R. Co., 35 Mich. 247 (semble).

¹ See *Wiggin v. Freewill Baptist Church*, 8 Met. (Mass.) 301; *Tuttle v. Michigan, etc. R. R. Co.*, 35 Mich. 247.

² But see contra: *Tuttle v. Michigan, etc. R. R. Co.*, 35 Mich. 247 (semble).

³ But as to ratification of unauthorized notice, see *infra*, § 1203.

As to the insufficiency of marked newspapers as notices, see *infra*, § 1203.

⁴ *Reilly v. Oglebay*, 25 W. Va. 36. Cf. *Johnston v. Jones*, 23 N. J. Eq. 216, 228.

⁵ *Langan v. Francklyn*, 29 Abb. N. C. (N. Y.) 102; 20 N. Y. Supp. 404.

⁶ *Lawyers Advertising Co. v. Consolidated Ry., etc. Co.*, 187 N. Y. 395; 80 N. E. 199.

⁷ *Jenner Institute of Preventive Medicine*, 15 Times L. R. 394; *Espuela Land, etc. Co.*, W. N. (1900) 139. See also *infra*, § 1204.

⁸ *Stockholders v. Louisville, etc. R. R. Co.*, 12 Bush (Ky.) 62.

But see *People v. Peck*, 11 Wend. (N. Y.) 604 (headnote misleading); 27 Am. Dec. 104.

As to the power to regulate by a by-law the mode of convening shareholders' meetings, see *Taylor v. Griswold*, 14 N. J. Law, 222; 27 Am. Dec. 33.

⁹ *Westcott v. Minnesota Mining Co.*, 23 Mich. 145.

But see *Samuel v. Holladay*, 1 Woolwich 400, 409 (as to notice of a directors' meeting).

¹⁰ *Stevens v. Eden Meeting House Soc.*, 12 Vt. 688.

¹¹ *Swansea Dock Co. v. Levien*, 20 L. J. Ex. 447.

§ 1202. **Length of Notice.** — As to the length of notice, one can only say that it must be reasonable, in the absence of some specific provision prescribing a definite length.¹ If one of the shareholders is in Europe, the notice need not be sufficient to enable him to reach home in time for the meeting.² If the by-laws or regulations of the company require, say, thirty days' notice, a notice of only twelve days renders the meeting invalid.³

§ 1203. **Ratification of unauthorized Notice.** — A notice of meeting sent out by the secretary without competent authority may, it has been held, be ratified by the directors and thus become valid by relation *ab initio*.⁴ According to the argument of the losing counsel in this case — the reporter's statement is not explicit — the ratification took place at a time when it was too late for the directors to give a new notice. If so, the case certainly goes very far, and is submitted to be not in harmony with the general principles of the law of agency;⁵ as in the case of a notice to quit, a notice of a meeting must be such as the person to whom it is given may rely upon.

§ 1204. **Conditional Notice.** — The notice in order to be effective must be unconditional. For instance, a notice that a meeting will be held provided certain resolutions are approved at a prior meeting is bad.⁶ If, subsequently, notice of the performance of the condition is sent out, that would be equivalent to an unconditional notice and would, it seems, be good;⁷ but it is not enough to send out a marked newspaper containing a report of the performance of the condition, since, although a shareholder is bound at his peril to read all official notices sent him by the directors, yet he is not bound to concern himself with marked newspapers which they may send for his perusal;⁸ and it

¹ Cf. *Long Island R. R. Co.*, 19 on Landlord & Tenant, 3d ed., 475; Wend. (N. Y.) 37; 32 Am. Dec. 429. ² Taylor on Landlord and Tenant,

³ *Jones v. Morrison*, 31 Minn. 9th ed., § 480; Mechem on Agency, 140, 149-150; 16 N. W. 854. Cf. § 179. ⁴ *Alexander v. Simpson*, 43 Ch. D. supra, § 1199.

But see *Brown v. Republican, etc.* 139. Cf. *Jenner Institute of Preventive Medicine*, 15 Times L. R. Mines, 55 Fed. 7. Cf. infra, § 1210.

⁵ *Re Keller*, 116 N. Y. App. Div. 394. ⁶ *Alexander v. Simpson*, 43 Ch. D. 58.

⁷ *Hooper v. Kerr, Stuart & Co.*, 139, 143 (per Chitty, J.). ⁸ *Alexander v. Simpson*, 43 Ch. D. 83 L. T. 729.

⁹ See Hufcutt on Agency, § 42, 139, 143-144, 145. and (as to notice to quit) Fawcett

makes no difference that he may have received notice unofficially from other sources.¹ But the notice is not rendered conditional by stating that in a certain contingency another notice would be given to the shareholders that the proposed meeting would not be held.² Moreover, the regulations or by-laws may allow a conditional notice, which in that event will be valid.³

§ 1205. **Construction of Notice.** — Some difficulty may be experienced in construing the notice, particularly in determining whether or not it is bad as conditional. Upon this point, the rule is that the notice must receive that construction which the average man of business would have put upon it at the time, and hence the court cannot, after the meeting has been held, strain the meaning of the notice in order to sustain the legality of the meeting.⁴ A single notice may serve to convene two distinct meetings;⁵ but where a notice convening a general meeting states that in the event of certain action being taken another meeting would be held immediately afterwards for the purpose of taking certain other action, it is obvious that what are spoken of as two meetings are really one, and therefore the notice is not bad as conditional — the meeting is to be held in any event, but certain business is to be brought before it only on a contingency.⁶

§ 1206. **Whether Notice must specify Purpose of Meeting.** — Not infrequently, it is provided that the notice convening any general meeting other than a stated meeting⁷ shall specify the business for which it is called, and that no other business shall be there transacted. The question has been left open in England, whether, in the absence of such provision, the notice is required to state the business to come before the meeting;⁸ and in America

¹ *Alexander v. Simpson*, 43 Ch. D. 139.

² *Espuela Land, etc. Co.*, W. N. (1900) 139.

³ *North of England S. S. Co.* (1905), 2 Ch. 15.

⁴ *Alexander v. Simpson*, 43 Ch. D. 139, 147.

⁵ *Supra*, § 1200.

⁶ *Tiessen v. Henderson* (1899), 1 Ch. 861.

Cf. *Griffing Iron Co.*, 63 N. J. Law 168, 173 (headnote inadequate) 41 Atl. 931.

⁷ Even when notice of a stated

annual meeting is required, there is no necessity of mentioning the business to be transacted, as an annual meeting is *ex vi termini* intended for the transaction of any and all business. *Warner v. Mower*, 11 Vt. 385 (where a by-law provided that all meetings should be convened by notice stating the object).

⁸ *Compagnie de Mayville v. Whitley* (1896), 1 Ch. 788.

See *Warner v. Mower*, 11 Vt. 385.

Cf. *Graham v. Van Dieman's Land Co.*, 1 H. & N. 541, 549, where the court refused to decide whether

the tendency is to hold that any special and extraordinary business is required at common law to be stated in the call.¹ This was declared to be true even though the charter provide that at special meetings "all or any business of the corporation may be transacted."²

§ 1207-§ 1208. *Express Regulations requiring Notice of Business to be transacted at Meeting.*

§ 1207. **In general — What Business may be transacted under miscellaneous Notices.** — To comply with a requirement that the business to be transacted at a meeting shall be specified in the call, a statement that a meeting is called to transact any business that may come before it is certainly quite ineffective.³ Moreover, the notice should be clear and frank, and particularly should disclose any special interest of the directors therein.⁴ For this reason, a notice calling a meeting to confirm a contract made by the directors for the sale of the company's undertaking is inadequate where the contract provides that the directors shall

a provision in a royal charter of incorporation stipulating that no business should be transacted at a special meeting except that for which it was called should be deemed mandatory or directory merely.

¹ *Tuttle v. Michigan, etc. R. R. Co.*, 35 Mich. 247; *People's Mutual Ins. Co. v. Westcott*, 14 Gray (Mass.) 440 (election of additional directors held to be such extraordinary business); *St. Mary's Benevolent Ass. v. Lynch*, 64 N. H. 213 (headnote inadequate); 9 Atl. 98 (vote to dissolve association); *People ex rel. Meads v. Alpha Lodge*, 13 N. Y. Misc. 677; 35 N. Y. Supp. 214 (expulsion of member); *Bagley v. Reno Oil Co.*, 201 Pa. 78; 50 Atl. 760; 56 L. R. A. 184 (alteration of by-laws); *Dunster v. Bernards Land, etc. Co.* (N. J.), 65 Atl. 123 (headnote inadequate — election of directors).

But see *Chicago, etc. Ry. Co. v. Union Pac. Ry. Co.*, 47 Fed. 15, 20.

It is a slightly different question whether when the notice mentions

but one object totally different business can be transacted. Cf. *American Tube Works v. Boston Machine Works*, 139 Mass. 5; 29 N. E. 63. But *Brewer, J.*, held on circuit that "the fact that other matters were specified in the notice in no manner limited the powers of the stockholders" at the meeting. *Chicago, etc. Ry. Co. v. Union Pac. Ry. Co.*, 47 Fed. 15, 20.

² *Atlantic Delaine Co. v. Mason*, 5 R. I. 463 (levy of an assessment on full-paid stock).

But see *Richardson v. Vermont, etc. R. R. Co.*, 44 Vt. 613.

³ *Gray v. Christian Society*, 137 Mass. 329; 50 Am. Rep. 310. Cf. *Dunster v. Bernards Land, etc. Co.* (N. J.), 65 Atl. 123 (headnote inadequate).

⁴ *Tiessen v. Henderson* (1899), 1 Ch. 861; *Normandy v. Ind. Coope & Co.* (1908), 1 Ch. 84.

Cf. *United Gold Co., etc. v. Smith*, 44 N. Y. Misc. 567; 90 N. Y. Supp. 199.

receive a bonus from the purchaser.¹ On the other hand, a notice calling a meeting for the purpose of adopting a new set of articles for the government of the company, and stating that the proposed new articles might be examined at the company's office is sufficient although the new articles increase the directors' compensation, give them additional pay for past services, and extend their term of office.² Notice of an intention to propose an alteration in the voting rights of shareholders will not justify a change in directors' qualifications.³ Notice of a meeting "to consider the question of an issue of bonds" justifies the passage of a resolution actually authorizing the issue, and does not confine the meeting to mere deliberation.⁴ Where a meeting is called to authorize an issue of stock, it is not necessary to specify the purpose to which the money obtained thereby is to be put.⁵ And it seems that even under an express regulation requiring business to come before the meeting to be stated in the call, it is not necessary to mention any business, such as the annual election of officers, of which the company's regulations themselves give notice.⁶ A meeting may be called for several distinct purposes provided all of them be sufficiently indicated in the notice.⁷ A special meeting may lawfully be called for the purpose of transacting business, such as the election of directors, that should regularly have come before a stated meeting.⁸ A report of the directors accompanying the notice may be used to eke out a meagre statement of the objects of the meeting in the notice itself.⁹

Ordinarily, a notice calling a meeting for a particular purpose does not prevent the adoption of a germane amendment to the resolution;¹⁰ but when the meeting is called to confirm a par-

¹ *Kaye v. Croyden Tramways Co.* N. H. 234, 240; 30 Atl. 614; 68 (1898), 1 Ch. 358.

Cf. *Jackson v. Munster Bank*, 13 L. R. Ir. 118.

² *Young v. South African Syndicate* (1896), 2 Ch. 268. But see *Normandy v. Ind, Coope & Co.* (1908), 1 Ch. 84.

³ *Henderson v. Bank of Australia*, 45 Ch. D. 330, 344.

⁴ *Evans v. Boston Heating Co.*, 157 Mass. 37, 41: 31 N. E. 698.

⁵ *Jones v. Concord, etc. R. R.*, 67

Am. St. Rep. 650.

⁶ *Sampson v. Bowdoinham, etc. Corp.*, 36 Me. 78.

Cf. *Warner v. Mower*, 11 Vt. 385.

⁷ *Graham v. Van Dieman's Land Co.*, 1 H. & N. 541.

⁸ *Austin Mining Co. v. Gemmel*, 10 Ont. 696.

⁹ *Boschoek Proprietary Co. v. Fuke* (1906), 1 Ch. 148, 164-165.

¹⁰ *Henderson v. Bank of Australia*, 45 Ch. D. 330; *Torbock v. Westbury* (1902), 2 Ch. 871.

ticular resolution, the shareholders must either accept it or reject it, and any amendment is out of order.¹

§ 1208. **What Business may be transacted at Adjourned Meetings.** — An adjourned meeting is but a continuation of the original meeting, and therefore may transact any business that might have been taken up at the former session;² and conversely no business can be transacted at an adjourned meeting that could not have been entertained at the original meeting.³ Although no notice of an adjourned meeting is necessary in order to enable any business to be taken up which might have been transacted at the original meeting, yet if in point of fact a notice is given which specifies certain particular business as the object of the adjournment, no business not thus mentioned can be transacted.⁴

§ 1209. **Presumption of Notice.** — Upon the principle, *omnia presumuntur rite esse acta*, the presumption of law always is that every meeting was convened by due notice.⁵

§ 1210. **Effect of Lack of Notice or Irregularity in Notice — Presence at Meeting as Waiver of insufficient Notice.** — The object of requiring notice of general meetings is to enable the shareholders to be present; and hence if a shareholder actually attends it becomes immaterial whether notice was given him or not;⁶ and, if all the shareholders attend, the meeting is quite

¹ *Wall v. London, etc. Assets Corp.* (1898), 2 Ch. 469. *Co. v. Gade*, 55 Ill. App. 181, 193; *Cuykendall v. Douglas*, 19 Hun (N. Y.) 577.

² *Warner v. Mower*, 11 Vt. 385, 391; *State ex rel. Ryan v. Cronan*, 23 Nevada 437; 49 Pac. 41. Cf. *Waite v. Windham, etc. Mining Co.*, 36 Vt. 18.

Cf. *Granger v. Grubb*, 7 Phila. 350. But see *Brown v. Dibble*, 65 Mich.

³ *Christopher v. Noxon*, 4 Ont. 520, 523 (headnote inadequate); 32 N. W. 656.

⁴ *Synnott v. Cumberland Bldg. Loan Ass'n*, 117 Fed. 379, 385; 54 C. C. A. 553 (semble). For other applications of the same presumption, see *McDaniels v. Flower Brook Co.*, 22 Vt. 274.

⁵ *Benbow v. Cook*, 115 N. Car. 324; 20 S. E. 453; 44 Am. St. Rep. 454; *Dunn v. New Orleans Bldg. Co.*, 8 La. 483; *Nelson v. Hubbard*, 96 Ala. 238, 249; 11 So. 428; 17 L. R. A. 375; *Forrest Glen Brick, etc. Co.* (N. Car.), 55 S. E. 854, 859. ⁶ See *infra*, § 1290. *Kenton Furnace, etc. Co. v. McAlpin*, 5 Fed. 737, 747; *Benbow v. Cook*, 115 N. Car. 324; 20 S. E. 453; 44 Am. St. Rep. 454; *Hill v. Atlantic, etc. R. R. Co.* (N. Car.), 55 S. E. 854, 859.

valid although no notice or an irregular one was given,¹ and that too even though the notice be expressly required by statute.² The same result has been reached where all the shareholders were present except those who held merely the bare legal title, the *cestui que trust* attending and participating in the meeting.³ When shares are owned by a firm, the presence of one partner is equivalent for this purpose to the presence of all.⁴

Sometimes, these same rules of law are expressed by saying that a shareholder may by his presence waive lack of notice, the requirement having been intended for his benefit. But any such "waiver" must take place at or before the meeting. For if a meeting is held without proper notice, the unnotified shareholders (or some of them) being absent, the proceedings are void, and may be disregarded by creditors as well as members of the company.⁵ So, if a meeting be convened by a notice issued

¹ *Handley v. Stutz*, 139 U. S. 417, 580; 54 Atl. 254; *P. B. Mathiason* 422 (headnote inadequate); 11 Sup. Ct. 530; *Columbia Nat. Bank's Appeal*, 16 Wkly. Notes Cas. (Pa.) 357 (headnote misleading); *Benbow v. Cook*, 115 N. Car. 324; 20 S. E. 453; 44 Am. St. Rep. 454; *Gripping Iron Co.*, 63 N. J. Law 168, 171, 174, 357; 41 Atl. 931; 46 Atl. 1097; *Wood v. Wiley Construction Co.*, 56 Conn. 87; 13 Atl. 137; *Gold Bluff Mining, etc. Corp. v. Whitlock*, 75 Conn. 669, 675; 55 Atl. 175 (stated

infra, § 1282); *Burke v. Sidra Bay Co.*, 92 N. W. 568; 116 Wisc. 137; *Sheldon Canal Co. v. Miller* (Tex.), 90 S. W. 206. As to the presence of attorneys for the shareholder, see *Re Keller*, 116 N. Y. App. Div. 58. As to attendance by proxy, see infra, § 1262.

² *Kenton Furnace, etc. Co. v. McAlpin*, 5 Fed. 737, 744-747; *Benbow v. Cook*, 115 N. Car. 324; 20 S. E. 453; 44 Am. St. Rep. 454; *State ex rel. Norvell-Shapleigh Hardware Co.*, 178 Mo. 189; 77 S. W. 559; *Riesterer v. Horton Land, etc. Co.*, 160 Mo. 141; 61 S. W. 238 (overruling *State v. McGrath*, 86 Mo. 241); *Tompkins v. Sperry*, 96 Md. 560,

This has been conceded in a number of cases. *Matthews v. Columbia Nat. Bank*, 79 Fed. 558; *Reilly v. Oglebay*, 25 W. Va. 36; *State v. Pettineli*, 10 Nevada, 141, 145.

Cf. *Weinburgh v. Union Street Ry. Co.*, 55 N. J. Eq. 640; 37 Atl. 1026; *Campbell v. Argenta, etc. Co.*, 51 Fed. 1.

But see contra: *Navajo, etc. Co. v. Curry*, 82 Pac. 247; 147 Cal. 581; 109 Am. St. Rep. 176.

³ *Wood v. Corry Water Works Co.*, 44 Fed. 146 (headnote inadequate); 12 L. R. A. 168.

Cf. *American Nat. Bank v. Oriental Mills*, 17 R. I. 551; 23 Atl. 795.

⁴ *Kenton Furnace, etc. Co. v. McAlpin*, 5 Fed. 737, 747-748.

⁵ *Cleveland, etc. Co. v. Taylor Bros. Co.*, 54 Fed. 82.

See also infra, § 1290. But see *Hill v. Atlantic, etc. R. R. Co.* (N. Car.), 55 S. E. 854, 859-860; *Vrooman v. Vansant Lumber Co.*, 64 Atl. 394; 215 Pa. St. 75 (lack of notice held immaterial when meeting attended by all the shareholders except one who afterwards "ratified")

by the secretary on the requisition of certain shareholders instead of by the directors as required by law, the meeting is void, and a resolution passed for the voluntary winding-up of the company is a nullity.¹ To be sure, by estoppel, a shareholder's participation without objection in a meeting that was not convened by due notice may preclude him from subsequently attacking the proceedings on that score;² and *a fortiori*, one who as director takes part in issuing the call will not be heard to question its efficiency.³ But as regards anybody who is free to allege the truth such a meeting is void.

It is true that some authorities, seizing on the principle that notice is required for the benefit of shareholders alone, have laid down the doctrine that want of notice can be objected to by no one else. Thus, where a mortgage of a company's property was authorized by a meeting the notice of which did not sufficiently describe the business to be transacted, it was held that the instrument could be impeached only by shareholders, and that, if they acquiesced, the purchaser of the company's title at an execution sale took subject to the mortgage.⁴ But it is submitted that cases of this sort should be supported either upon the ground that such acquiescence of the company was shown as to

the action taken). Of course, if the shareholders acquiesce in the action of the irregularly convened meeting, the company will be bound. *Holmes v. Royal Loan Ass'n* (Mo.), 107 S. W. 1005.

¹ *State of Wyoming Syndicate* (1901), 2 Ch. 431. Cf. *State ex rel. Bellamore v. Rombotis* (La.), 45 So. 43.

² *Bucksport, etc. R. R. Co. v. Buck*, 68 Me. 81; *Kenton Furnace, etc. Co. v. McAlpin*, 5 Fed. 737, 745; *British Sugar Co.*, 3 K. & J. 408; *Schenectady, etc. Co. v. Thatcher*, 11 N. Y. 102; *Germer v. Triple-State, etc. Oil Co.* (W. Va.), 54 S. E. 509.

Cf. *Callahan v. Chilcott Ditch Co.* (Colo.), 86 Pac. 123 (holding that shareholder who pays an assessment levied at a meeting convened without proper notice cannot object to an assessment levied at an adjournment of that meeting on the ground that proper notice was not given).

As to the effect of participation by proxy see *infra*, § 1262.

An assignee of a shareholder who participated in the meeting will be estopped to the same extent as his transferor. *British Sugar Co.*, 3 K. & J. 408.

³ *Christopher v. Noxon*, 4 Ont. 672, 680; *Bucksport R. R. Co. v. Buck*, 68 Me. 81.

⁴ *Beecher v. Marquette, etc. Co.*, 45 Mich. 103; 7 N. W. 695. The same principle has been acted on in other cases; *Nelson v. Hubbard*, 96 Ala. 238; 11 So. 428; 17 L. R. A. 375; *Bridgport, etc. Ice Co. v. Meader*, 72 Fed. 115, 119-120 (head-note inadequate); 18 C. C. A. 451; *Campbell v. Argenta, etc. Co.*, 51 Fed. 1; *Central Trust Co. v. Condon*, 67 Fed. 84, 103-104; 14 C. C. A. 314; *State Nat. Bank v. Duncan* (Miss.), 35 So. 569.

constitute a ratification or confirmation of the originally irregular transaction, or else upon the ground that, under the rule in *Royal British Bank v. Turquand*, the transaction was *ab initio* valid in favor of innocent third persons.¹

Of course, action taken at a meeting of which due notice was not given may be ratified at a subsequent meeting duly called.²

§ 1211. **Place of Meetings** — *In general*. — The place at which shareholders' meetings shall be held may generally be determined by the directors or other authority having power to convene meetings,³ although of course it may be fixed by the company's regulations. A regulation respecting the place of meetings will receive a liberal construction in order to sustain the validity of a meeting. Thus, where it was provided that general meetings should be held at the company's counting-room, and a meeting was held at a room in the residence of one of the officers, the court indulged a presumption that that room was, *pro hac vice* at any rate, the company's counting room.⁴ Doubtless where the place of meeting is discretionary with the directors or other authority, the place selected must be a reasonable one.

§ 1212. *Meetings held outside the Company's Home State*. — According to the view prevailing in the United States, general meetings cannot be held outside the territory of the sovereignty under whose laws the corporation is formed,⁵ and the rule is not altered because the statute gives a general authority to

¹ See *infra*, § 1289.

² *Richardson v. Vermont, etc. R. R. Co.*, 44 Vt. 613. Cf. *Hill v. Atlantic, etc. R. R. Co.* (N. Car.), 55 S. E. 854, 859-860 (where the tabling of a resolution to rescind the previous action was held to be a ratification).

³ In the case of religious corporations, it seems that meetings can only be held at their usual place of worship. *Den ex dem. Am. Primitive Society v. Pilling*, 24 N. J. Law 653.

Cf. *Juker v. Commonwealth ex rel. Fisher*, 20 Pa. St. 484.

⁴ *McDaniels v. Flower Brook Co.*, 22 Vt. 274.

⁵ *Miller v. Ewer*, 27 Me. 509; 46 Am. Dec. 619; *Franco-Texan Land Co. v. Laigle*, 59 Tex. 339 (headnote misleading); *Ormsby v. Vermont Copper Co.*, 56 N. Y. 623; *Bellows v. Todd*, 39 Iowa 209 (semble); *Aspinwall v. Ohio, etc. R. R. Co.*, 20 Ind. 492; 83 Am. Dec. 329; *Bastian v. Modern Woodmen*, 166 Ill. 595, 600-601; 46 N. E. 1090.

This rule is sometimes expressly affirmed by statute; *Hilles v. Parrish*, 14 N. J. Eq. 380; *Hodgson v. Duluth, etc. R. R. Co.*, 46 Minn. 454, 457; 49 N. W. 197.

A corporation chartered concurrently by two states may lawfully

the directors or some other body to fix the place of meeting.¹ But no satisfactory reason can be assigned for this doctrine.² The ground usually taken is that a corporation has no legal existence outside its home state and can therefore do no corporate act, such as holding a shareholders' meeting, except within the jurisdiction of its own sovereign. But the major premiss of this syllogism is an antiquated and worn-out dogma which everybody knows to be false in point of fact. Moreover, the question is not whether one state will recognize the existence of a corporation created by another, but whether a state will refuse to treat as valid the acts of its own corporations simply because they were performed outside its borders. The whole matter turns on the intent of the laws of the state that creates the corporation.³ This is demonstrated by the fact that where those laws expressly authorize meetings to be held in other states, they may lawfully be so held,⁴ and by the converse fact that permission from the foreign state to hold the meetings within its limits is immaterial.⁵ Moreover, even without express authorization a meeting held without the state is valid against those shareholders who actually attend and participate, so that where all the shareholders are present the proceeding is unimpeachable.⁶ Whether a charter can lawfully be accepted outside the state, or whether a corporation's first or organization meeting must take place in its home jurisdiction, is perhaps a somewhat different question.⁷ Of

hold meetings in either. *Bridge Co. v. Mayer*, 31 Oh. St. 317.

¹ *Miller v. Ewer*, 27 Me. 509; 46 Am. Dec. 619.

² *Ohio, etc. R. R. Co. v. McPherson*, 35 Mo. 13, 27; 86 Am. Dec. 128 (semble); *Wright v. Lee*, 2 S. Dak. 596, 620-622; 51 N. W. 706; *Heath v. Silverthorn, etc. Co.*, 39 Wisc. 146.

³ It is a different question whether a state will recognize the validity of corporate acts done within its own borders by a corporation created by a foreign sovereign. This was the real question in *Duke v. Taylor*, 37 Fla. 64; 19 So. 172; 53 Am. St. Rep. 232; 31 L. R. A. 484. Cf. *Smith v. Silver Valley Mining Co.*, 64 Md. 85; 20 Atl. 1032; 54 Am. Rep. 760.

⁴ Cf. *Humphreys v. Mooney*, 5 Colo. 282; *Bastian v. Modern Woodmen*, 166 Ill. 595, 601-602; 46 N. E. 1090.

⁵ *Aspinwall v. Ohio, etc. R. R. Co.*, 20 Ind. 492; 83 Am. Dec. 329.

⁶ *Handley v. Stutz*, 139 U. S. 417; 11 Sup. Ct. 530 (increase of capital); *Wright v. Lee*, 2 S. Dak. 596, 620; 51 N. W. 706; *Missouri Lead, etc. Co. v. Reinhard*, 114 Mo. 218; 21 S. W. 488; 35 Am. St. Rep. 746 (election of directors and authorization of deed).

But see *Franco-Texan Land Co. v. Laigle*, 59 Tex. 339 (headnote inadequate).

⁷ See *supra*, § 178.

course when the by-laws require the meetings to be held at a specified place within the state, a meeting held without the state is void unless all the shareholders attend.¹

§ 1213. **Time of Meetings.** — The meetings of the company may, in the absence of provisions to the contrary, be held at any reasonable time.² If, however, the company's regulations forbid certain business to be taken up except at a meeting held on a certain date, perhaps that particular business cannot legally be transacted at any other time.³ Where the articles of association of an English company provide that an annual general meeting shall be held at such time as may be prescribed by the company in general meeting and if no time be so prescribed then in the month of April, nevertheless if the company never holds a meeting in April but meets in February or March without any previous resolution of the shareholders fixing such dates, those meetings are deemed for all purposes the regular annual meetings of the company.⁴

§ 1214. **Quorum.** — A shareholders' meeting, in order to take regular action, must be attended by a quorum, and we must therefore consider how many members are necessary to constitute a quorum. It has been held that at least two shareholders are always necessary.⁵ The Louisiana court has held that a meeting must be attended by a majority of all the members;⁶ but, in the absence of regulations fixing a quorum, the general doctrine is that where a meeting is duly convened the

¹ *Hodgson v. Duluth, etc. R. R.* 378; 55 N. W. 547; 21 L. R. A. Co., 46 Minn. 454; 49 N. W. 197. 174.

² A charitable or benevolent corporation may meet on Sunday. Cf. *Gilchrist v. Collopy*, 82 S. W. 1018; 26 Ky. Law Rep. 1003.

McCabe v. Father Matthew, etc. Soc., 24 Hun (N. Y.) 149. But as to a business corporation, see *Agudath Hakehiloth*, 18 N. Y. Misc. 717; 42 N. Y. Supp. 985. ⁶ *Peirce v. New Orleans Bldg. Co.*, 9 La. 397 (headnote inadequate); 29 Am. Dec. 448.

See also Sayles v. Brown, 40 Fed. Rep. 8, 13 (headnote inadequate);

³ *Weatherby v. Medical, etc. Soc.*, 76 Ala. 567. But see *infra*, § 1245. *Stewart v. Mahoney Mining Co.*, 54 Cal. 149; *People ex rel. Probert v. Robinson*, 64 Cal. 373, 374-375; 1 Pac. 156; *People v. Twaddell*, 18 Hun (N. Y.) 427, 430 (headnote inadequate); *Mayor, etc. of Merchants of the Staple v. Bank of England*, 21 Q. B. D. 160, 165 (per Wills, J., *obiter*).

⁴ *Borland's Trustee v. Steele Bros. & Co.* (1901), 1 Ch. 279, 293-294 (headnote inadequate).

⁵ *Sharp v. Dawes*, 2 Q. B. D. 26.

But see *contra*: *Morrill v. Little Falls Mfg. Co.*, 53 Minn. 371, 377-

shareholders who attend, however few, are competent to transact business.¹ Where a quorum of shareholders is fixed by the regulations, any action taken at a meeting attended by less than such quorum is void;² and this rule applies even to statutory meetings under the British Companies Acts at which a resolution for liquidation is passed.³ If two inconsistent by-laws are in force as to the number necessary to constitute a quorum, the matter will be regulated by the general law.⁴ A provision that a quorum shall consist of a majority or one third of the stock, requires a majority or one third of the stock actually subscribed, and not a majority or one third of the total authorized capital stock of the corporation.⁵ Indeed, a by-law fixing one third of

¹ *Morrill v. Little Falls Mfg. Co.*, 53 Minn. 371; 55 N. W. 547; 21 L. R. A. 174. *Ex parte Willcocks*, 7 Cow. (N. Y.) 402; 17 Am. Dec. 525 (semble); *Madison Ave. Baptist Church v. Baptist Church*, 5 Rob. (N. Y.) 649; *Field v. Field*, 9 Wend. (N. Y.) 394; *Granger v. Grubb*, 7 Phila. 350, 356; *Re Rapid Transit Ferry Co.*, 15 N. Y. App. Div. 530; 44 N. Y. Supp. 539; *Sylvania, etc. R. Co. v. Hoge* (Ga.), 59 S. E. 806; *Gilchrist v. Collopy*, 82 S. W. Rep. 1018; 26 Ky. Law Rep. 1003; *Eagle Iron Co. v. Colyar*, 156 Fed. 954.

Cf. *Gowen's Appeal*, 10 Wkly. N. Cas. (Pa.), 85; *Rez v. Amery*, 1 T. R. 575, 588. The rule stated in the text is based upon the old rule of the common law that where a corporation consists of an indefinite number of members, those who attend, however few, at any duly convened meeting are competent to act, but that where the number is definite a majority must meet. See Grant on Corporations 68; *Hascard v. Somany*, Freem. 504. Yet it should be observed that modern joint-stock corporations, although composed of an indefinite number of members, consist of a definite number of shares or voting units. If the question were *res integra*, there would be, therefore, strong ground to

argue that a majority of the shares must be represented at any meeting if the voting is to be by shares.

In *Juker v. Commonwealth ex rel. Fisher*, 20 Pa. St. 484, the court went so far as to hold that an election at the appointed time and place was valid although a majority of the electors had been excluded from the room.

The phrase "majority of the members" of a corporation has been held to mean majority of the members present at a regular meeting. *Craig v. First Presbyterian Church*, 88 Pa. St. 42; 32 Am. Rep. 417.

² *Mott's Case*, 23 W. R. 405; *Rapid Transit Ferry Co.*, 43 N. Y. Supp. 538; 19 Misc. 409.

³ *Howling's Trustees v. Smith*, 7 Fraser (Sc.) 390.

⁴ *New York Electrical Workers' Union v. Sullivan*, 107 N. Y. Supp. 886.

⁵ *Austin Mining Co. v. Gemmell*, 10 Ont. 696, 703; *Castner v. Twitchell-Champlin Co.*, 91 Me. 524; 40 Atl. 558.

But see *Ellsworth, etc. Manufacturing Co. v. Faunce*, 79 Me. 440; 10 Atl. 250 (distinguished in *Castner v. Twitchell-Champlin Co.*, supra). Cf. *Greenpoint Co. v. Whitin*, 69 N. Y. 328; *Market Street Ry. Co. v. Hellman*, 109 Cal. 571; 42 Pac. 225.

the total authorized capital as a quorum at a time when less than a third has been issued would be equivalent to corporate suicide, and would therefore be unreasonable and void.¹ Shareholders present by proxy are to be reckoned as present in determining whether a quorum is in attendance.² Where a statute provides that directors shall be elected by "such of the stockholders as shall attend" a duly convened general meeting, a by-law attempting to require the presence of representatives of a majority of the shares has been held to be in conflict with the statute and therefore void.³

Upon the principle, *omnia presumuntur rite esse acta*, the presence of a quorum at any meeting at which business is transacted is always to be presumed in the absence of affirmative evidence to the contrary.⁴

§ 1215. **Expedients to procure full Attendance at Meeting — Duty of shareholders to attend.** — A full attendance at corporate meetings is to be desired, and hence a by-law fining members who refuse to attend meetings was once held to be valid.⁵ Whether a similar by-law would be possible in the case of modern joint-stock corporations may be doubted; but the power of the company to adopt reasonable measures for securing a large attendance at general meetings is beyond dispute.⁶ Although in one sense it may be said to be the duty of every shareholder to attend the meeting, yet ordinarily a shareholder by absenting himself forfeits or surrenders no right beyond the right to participate in that meeting.⁷

¹ *Castner v. Twitchell-Champlin* Atl. 529. Cf. *Waite v. Windham, etc. Co.*, 91 Me. 524, 531; 40 Atl. 558 *Mining Co.*, 36 Vt. 18. (semble).

² *Franklin Trust Co. v. Rutherford Electric Co.*, 57 N. J. Eq. 42; 41 Atl. 488 (affirmed 58 N. J. Eq. 584; 43 Atl. 1098).

³ *Darrin v. Hoff*, 99 Md. 491; 58 Atl. 196.

⁴ *Citizens' Mutual Ins. Co. v. Sortwell*, 8 Allen (Mass.) 217, 223; *Commonwealth v. Woelper*, 3 Serg. & R. (Pa.) 29; 8 Am. Dec. 628; *Coombs v. Harford*, 99 Me. 426; 59

But see *People v. Twaddell*, 18 Hun (N. Y.) 427, 430 (headnote inadequate).

There is no presumption that any particular shareholder was present at a meeting. *Martin v. Eagle Development Co.*, 41 Oreg. 448; 69 Pac. 216.

⁵ *London Tobacco Pipe-Makers' Co. v. Woodruffe*, 7 B. & C. 838.

⁶ Cf. *supra*, § 96.

⁷ *Sylvania, etc. R. Co. v. Hoge* (Ga.), 59 S. E. 806.

§ 1216-§ 1239. VOTING RIGHTS AT SHAREHOLDERS' MEETINGS.

§ 1216. Whether one Shareholder can have more than one Vote.

— Just as each director has one vote in a board meeting irrespective of the number of shares that he may hold, so at common law each shareholder had one vote, and one vote only, no matter how numerous the shares of which he was owner.¹ "One man, one vote," was the common-law rule. But although that principle is good democratic doctrine and works very fairly in the government of the state, yet it was most unsatisfactory in the management of private corporations. In respect to the management of private property the amount of a man's interest should be the measure of his power. Consequently, by statute and by the regulations or by-laws of companies, a different scale of voting has been very generally provided. Even at the present day, however, the old common-law principle applies except in so far as altered by statute or the company's regulations.² Indeed, it was held in an early New Jersey case that a mere by-law cannot alter the common-law rule,³ but upon the latter point the better view is contra.⁴

§ 1217. Regulations limiting Number of Votes to be cast by any one Shareholder. — When first it became customary to allow one shareholder more than one vote, not uncommonly some limit was fixed to the number of votes he might cast. For instance, it would be provided that a shareholder should have one vote for each share held by him, not to exceed, say, ten votes.⁵ Or, it would be provided that a shareholder should have one vote for each share up to a certain number and one vote for each two additional shares, say, up to twice that number, and so on.

¹ *Horbury Bridge Co.*, 11 Ch. D. 109; *Taylor v. Griswold*, 2 Green (N. J.) 222; 27 Am. Dec. 33; *Commonwealth v. Conover*, 10 Phila. 55.

⁴ *Commonwealth v. Detwiller*, 131 Pa. St. 614; 18 Atl. 990; 7 L. R. A. 357; *Procter Coal Co. v. Finley*, 98 Ky. 405; 33 S. W. 188.

² *Horbury Bridge Co.*, 11 Ch. D. 109.

But see contra, *P. B. Mathiason Mfg. Co.* (Mo.), 99 S. W. 502.

³ *Taylor v. Griswold*, 2 Green (N. J.) 222; 27 Am. Dec. 33.

Cf. *Commonwealth v. Conover*, 10 Phila. 55.

⁵ It has been held that such a statutory provision relating to "elections" applies not merely to elections of officers but to other questions that may come before a shareholders' meeting. *McKee v. Home Savings & Trust Co.*, 98 N. W. 609; 122 Iowa 731.

Where, by a provision of this sort, no shareholder is permitted to cast more than one hundred votes, a shareholder may cast one hundred votes in respect of one hundred shares standing in his own name and also another hundred votes in respect of shares standing in his wife's name.¹ Under such provisions, if a man could distribute his shares among a number of trustees or agents, obviously his voting strength might be largely increased. In England the courts have held that such distribution of shares among nominees for the purpose of augmenting one's voting power was not merely not unlawful,² but was even a legal right of the shareholder of which the officers of the corporation would be enjoined from attempting to deprive him.³ In some of the United States, on the other hand, the endeavor to increase one's voting power in that way is held to be illegal.⁴ But even where this latter view is adopted, the courts are practically powerless to prevent the practice disapproved of.

§ 1218. **Rule of one Vote for each Share.** — For this reason, as well as on grounds of inherent justice, it is almost universal nowadays to provide that every shareholder shall have as many votes as he holds shares. In the United States this rule is generally prescribed by statute; and where that is the case the company cannot by mere by-law limit the number of votes that any one shareholder may cast.⁵ Under the more elastic English system each corporation regulates the matter for itself, and therefore a provision authorizing proportionate voting will generally be found in the articles of each English company. In an early New Jersey case cited in a former paragraph, it was held that a mere by-law purporting to alter the common-law rule so as to give one vote for each share was void;⁶ but accord-

¹ *Conant v. Millaudon*, 5 La. Ann. v. *Ridgely*, 38 Md. 364; *Mack v. 542* (headnote inadequate). *De Bardeleben Co.*, 90 Ala. 396; 8

² *Pender v. Lushington*, 6 Ch. D. So. 150; 9 L. R. A. 650.

70. Cf. *Scott v. Scott*, 68 N. H. 7 (headnote inadequate); 38 Atl. 567; 44 N. J. Law 529; *Conant v. Millaudon*, 5 La. Ann. 542 (headnote 234 (headnote inadequate); *Bartlett v. Fourton*, 38 So. 882; 115 La. Ann. 26 (semble).

³ *Cannon v. Trask*, 20 Eq. 669; *Scranton Iron Co.*, 16 Eq. 559.

⁵ *Beckett v. Houston*, 32 Ind. 393.

Cf. *Moffat v. Farquhar*, 7 Ch. D. 591.

⁶ *Taylor v. Griswold*, 2 Green (N. J.) 222; 27 Am. Dec. 33.

⁴ *Campbell v. Poultney*, 6 G. & J. (Md.) 94; 26 Am. Dec. 559; *Webb* Phila. (Pa.) 55.

ing to the weight of authority such a by-law is valid.¹ Sometimes provision is made for minority representation in the board of directors, but this can hardly be deemed a departure from the ordinary proportionate scale of voting. *Prima facie*, perhaps, the words "majority of stockholders" may mean numerical majority;² but where the regulations provide for proportionate voting a provision that amendments to the by-laws must be carried by a "majority of the stockholders" will be construed to mean a majority in interest,³ and a regulation that directors may be expelled on a two-thirds vote of the stockholders will likewise be construed to mean two thirds in interest.⁴ Wherever proportionate voting is the law of the company, the American authorities hold that each shareholder has a right to demand that the same scale of voting must be followed, not merely in election of officers,⁵ but in the choice of a chairman,⁶ on a motion to adjourn,⁷ or on any other question that may come before the meeting.

The fact that shares have been purchased in order to augment the purchaser's voting strength is undoubtedly no reason for refusing to receive his vote in respect of them.⁸

§ 1219. "Cumulative Voting" at Elections of Directors. — Sometimes, by statute, where there are several directors to be elected, the shareholder is allowed to give one candidate as many votes as the number of his shares multiplied by the number of offices to be filled.⁹ This is sometimes called "cumulative voting." Under this system, as under the simpler rule, a plurality of votes is all that is necessary to elect;¹⁰ and if less than an entire board is elected, the vacancy should be filled by another

¹ *Commonwealth v. Detwiller*, 131 Pa. St. 614; 18 Atl. 990; 7 L. R. A. 357; *Procter Coal Co. v. Finley*, 98 Ky. 405; 33 S. W. 188.

² *Taylor v. Griswold*, 2 Green (N. J.) 222, 239; 27 Am. Dec. 33.

³ *Weinburgh v. Union Street Ry.* Co., 55 N. J. Eq. 640; 37 Atl. 1026.

⁴ *State ex rel. Mitchell v. Horan*, 22 Wash. 197; 60 Pac. 135.

⁵ Cf. *supra*, p. 1013, n. 5.

⁶ *Procter Coal Co. v. Finley*, 98 Ky. 405; 33 S. W. 188. See further

as to the right to demand a poll, *infra*, § 1251.

⁷ *Rochester District Tel. Co.*, 40 Hun (N. Y.) 172.

⁸ *Toronto Brewing Co. v. Blake*, 2 Ont. 175.

⁹ See *Schwartz v. State*, 61 Oh. St. 497; 56 N. E. 201; *Wright v. Commonwealth*, 109 Pa. St. 560; 1 Atl. 794; *P. B. Mathiason Mfg. Co.* (Mo.), 99 S. W. 502, and many other cases.

¹⁰ *Wright v. Commonwealth*, 109 Pa. St. 560; 1 Atl. 794.

ballot, at which also, if there is more than one vacancy, the electors may cumulate their votes.¹ Where the system of cumulative voting prevails, a ballot which fails to indicate the number of votes cast for each person named therein is a nullity.² And where cumulative voting is the law of the company, the majority cannot evade the rule by holding as many ballots, each for a single director, as there are offices to be filled.³ And of course the majority cannot by a mere resolution or by-law directly nullify a statutory provision for cumulative voting.⁴ Where cumulative voting is permitted, the right to accumulate one's votes is absolute and may be exercised without any statement of an intention so to do,⁵ and irrespective of the motives of the voter.⁶ A provision that "each share shall entitle the owner to as many votes as there are directors to be elected" is not sufficient to authorize cumulative voting;⁷ and indeed a provision that "each share shall entitle the owner to one vote for each director" has been held to have the effect of repealing a previous provision for cumulative voting.⁸

§ 1220-§ 1239. *Who may vote as a Shareholder.*

§ 1220. **In general — Right of Registered Holder.** — The general rule is that the registered holder of shares is the person entitled to vote in respect thereof. Indeed, this must be so; for one of the chief reasons for requiring a register of shareholders to be kept is to enable the company to determine who are entitled to vote at its meetings.⁹ Consequently, the rule ought to be the same whether the register is required to be kept by statute or merely by the company's regulations, and whether or

¹ *Forsyth v. Brown*, 33 Wkly. Notes Cas. (Pa.) 72.

Cf. *Wright v. Commonwealth*, 109 Pa. St. 560; 1 Atl. 794.

² *P. B. Mathiason Mfg. Co. (Mo.)*, 99 S. W. 502.

³ *Wright v. Central, etc. Co.*, 67 Cal. 532; 8 Pac. 70.

⁴ *Tomlin v. Farmers', etc. Bank*, 52 Mo. App. 430.

⁵ *Peirce v. Commonwealth*, 104 Pa. St. 150.

⁶ *Chicago Macaroni Co. v. Boggi-ano*, 202 Ill. 312; 67 N. E. 17.

⁷ *State v. Stockley*, 45 Oh. St. 304; 13 N. E. 279; *State ex rel. Dent v. Holloway*, 1 Oh. Circ. Dec. 90.

⁸ *Attorney-General ex rel. Hurley v. Bridgman*, 96 N. W. 438; 134 Mich. 379.

⁹ A statutory provision requiring a list of the shareholders entitled to vote with the shares held by each to be made out ten days before a meeting, has been held to be directory merely. *Downing v. Potts*, 23 N. J. Law 66.

not the shares are transferable only on the company's books. To this effect is the weight of authority;¹ but some cases, notably in the California courts, incline to hold that the "real owner" is always entitled to vote irrespective of the state of the register, unless a statute prescribe otherwise.² Sometimes, by express statute, the register of shareholders is made the conclusive criterion of the right to vote;³ and there certainly no room for doubt exists. The books which determine the right of a person offering to vote are the original register of shareholders and not any mere transcripts therefrom, such as "stock ledgers";⁴ but the stubs of the certificate-book may serve the purpose if the company keeps no other record.⁵ The want of a share-certificate will not debar a registered shareholder from voting.⁶ Nor is payment for his shares a necessary qualification

¹ *State v. Ferris*, 42 Conn. 560; *Wentworth Co. v. French*, 176 Mass. 442; 57 N. E. 789; *State ex rel. Ryan v. Cronan*, 23 Nevada 437; 49 Pac. 41; *Mousseaux v. Urquhart*, 19 La. Ann. 482; *Third Nat. Bank v. Jackson*, 156 Fed. 144, 148.

Where the shares were transferable only on the books of the company: *Morrill v. Little Falls Mfg. Co.*, 53 Minn. 371; 55 N. W. 547; 21 L. R. A. 174; *Argus Printing Co.*, 1 N. Dak. 434; 48 N. W. 347; 26 Am. St. Rep. 639. Cf. *Long Island R. R. Co.*, 19 Wend. (N. Y.) 37; 32 Am. Dec. 429; *Reynolds v. Bridenthal*, 57 Nebr. 280; 77 N. W. 658.

As to the right of the executor of a deceased registered shareholder, see *infra*, § 1227.

² *Smith v. San Francisco, etc. Ry. Co.*, 115 Cal. 584; 47 Pac. 582; 35 L. R. A. 309; 56 Am. St. Rep. 119; *Allen v. Hill*, 16 Cal. 113.

Cf. *People ex rel. Probert v. Robinson*, 64 Cal. 373; 1 Pac. 156; *Market Street Ry. v. Hellman*, 109 Cal. 571; 42 Pac. 225.

The rule in Pennsylvania is peculiar. "*Prima facie* the right to vote accompanies the legal title, but where the title is divided and an equity exists, as between pledgor

and pledgee, trustee and *cestui que trust*, or, as in the present case, between vendor and a vendee with a title inchoate until payment, the right to vote is subject to the agreement of the parties. This is the rule not merely of the common law but also of the act of 1889." *Commonwealth v. Patterson*, 158 Pa. St. 476, 494; 27 Atl. 998. Cf. *infra*, p. 1023, n. 5.

³ See *Re Argus Printing Co.*, 1 N. Dak. 434; 48 N. W. 347; 26 Am. St. Rep. 639; *Utica Fire Alarm Telegraph Co.*, 115 N. Y. App. Div. 821.

⁴ *Downing v. Potts*, 23 N. J. Law 66.

But see *Cedar Grove Cemetery Co.*, 61 N. J. Law 422 (headnote inadequate); 39 Atl. 1024; and *supra*, § 1129, § 864.

Cf. *Consolidated Telegraph, etc. Co.*, 43 Atl. Rep. 433 (N. J.).

⁵ *Utica Fire Alarm Co.*, 115 N. Y. App. Div. 821, 828. Cf. *U. S. Cast Iron Pipe, etc. Co.* (N. J.), 65 Atl. 849 (holding that to have at the meeting stubs of a certificate book with cancelled certificates pasted in is compliance with a statute requiring the directors to have the stock book at the meeting). See also *supra*, § 172, § 864, § 1129.

⁶ *Beckett v. Houston*, 32 Ind. 393.

of a voter at corporate meetings.¹ Indeed, one who is in arrear for calls due and unpaid is nevertheless entitled to vote, unless prevented by some provision in the company's regulations.² On the other hand, a person who denies that he is a shareholder and who is appealing from a decision against him on that point should not be allowed to vote:³ he must not blow hot and cold.

§ 1221. **Exception — Name of qualified Shareholder omitted from Register through Company's Fault.** — Certainly, the rule that registered shareholders, and they alone, are qualified to vote is not without exception. For if by the negligence or wilful misconduct of the corporation or its officers the name of a duly qualified shareholder is omitted from the register, he will nevertheless be entitled to vote.⁴ For instance, if a transferee of shares receives from the vendor the certificate of stock endorsed in the usual form, and presents the same at the company's transfer office for registration, he will be entitled to vote at subsequent meetings, although the corporation by an oversight should fail to record the transfer, leaving the vendor still the registered owner.

This principle was applied in a case where a pledgor of shares delivered to the pledgee his certificate of stock with a power of attorney to effect a transfer on the register endorsed thereon. The understanding of the parties was that the power of attorney should be used only in case of the pledgor's default in payment of the debt. The pledgee, however, before default, wrongfully procured the shares to be transferred on the register into his own name. The court held, that the registration of the transfer being wrongful, the true owner, namely, the pledgor, remained entitled to vote.⁵ This would undoubtedly be true if the company had had notice of the agreement between the parties; but, as the case stood, the company was no party to the pledgor's wrong, and moreover the pledgor by executing the power of attorney had clothed the pledgee with apparent authority to complete the transfer, and should bear the consequences.

¹ Cf. *Lincoln v. State*, 36 Ind. 161; ⁴ *Noller v. Wright*, 101 N. W. Price v. Holcombe, 89 Iowa 123; 56 553; 138 Mich. 416; *Mitchell v. N. W.* 407. See also infra, § 1222. *Colorado Fuel, etc. Co.*, 117 Fed. 723

² As to the effect of such a regulation, see *Randt Gold Mining Co. v. Wainright* (1901), 1 Ch. 184. (where the corporation failed to keep the required transfer book). ⁵ *State v. Smith*, 15 Oreg. 98; 14

³ Cf. *Lincoln v. State*, 36 Ind. 161. Pac. 814; 15 Pac. 137, 386.

Accordingly, it is submitted that while the principle is sound that a person whose name has been removed from the register by the fault of the corporation continues entitled to vote, yet the learned court should have held that in the case before them the registration of the transfer, although wrongful as between pledgor and pledgee, was rightful as between the pledgor and the company, and that consequently the pledgee was entitled to vote.

Moreover, the principle should not be applied unless the corporation is clearly at fault. Thus, where the company omits to send to the post-office for a registered letter which in fact contained an endorsed certificate of stock accompanied with a direction to record the transfer but of the contents of which the company had no notice, the company is not at fault in failing to record the transfer, and accordingly the transferee is not entitled to vote until the transfer is actually registered.¹

§ 1222. **Holder of Shares issued Ultra Vires, at a Discount, etc.** — Another exception to the general rule is that where shares are issued *ultra vires*, the holders are not entitled to vote, although their names may appear on the register of shareholders. Thus, where stock is issued in excess of the authorized capital of the company, the holders of such over-issued stock may not vote in respect thereof.² But the mere fact that a shareholder has paid nothing for the shares for which certificates have been issued to him will not disentitle him to vote in respect thereof.³ At most, such a shareholder is subject to a liability to pay in the par value of his shares.

Moreover, shares which are issued fraudulently, for the purpose of increasing the voting strength of the faction of the company to which the directors belong, will not confer upon the holders any voting rights, unless indeed the shares have come to the hands of a purchaser for value without notice of the circumstances under which they were issued.⁴

§ 1223. **Shares held in Trust.** — As the common law regards a trustee as the absolute owner of the trust property, and as even courts of equity regard him as the proper representative of the trust estate, — as the proper party to institute suits and

¹ *Glen Salt Co.*, 17 N. Y. App. Div. 234; 45 N. Y. Supp. 568.

³ *Downing v. Potts*, 23 N. J. Law 66. See also *supra*, § 1220.

² *Downing v. Potts*, 23 N. J. Law 66, 84. See also *supra*, § 579.

⁴ Cf. *Punt v. Symons & Co.* (1903), 2 Ch. 506, 515-517.

to make contracts on its behalf, — it is only natural that the trustee of shares and not the *cestui que trust* should be deemed entitled to vote in respect of the trust shares at corporate meetings. Such is the law, except where altered by statute, even when the company has notice of the trust, and even when both the fact of the trust and the name of the beneficiary are entered on the register.¹ *A fortiori*, therefore, the trustee is alone entitled to vote where the trust is not entered on the register,² or where the name of the beneficiary is not given;³ and in England the entry of a trust on the register is expressly prohibited by statute.⁴ The right of the trustee to vote extends to any matter upon which a person holding shares in his own right might vote; and hence the trustee may consent to the destruction of the company by consolidation or amalgamation with another company.⁵ The administrator of a trustee of shares, since he holds the legal title thereto, is entitled to vote in respect of them;⁶ but this right of his would yield naturally to that of a successor in the trust duly appointed by chancery. *A fortiori*, the legal owner is entitled to vote on shares he holds subject not to an actual trust but to an equity which, however, has not been enforced.⁷

The trustee's right to vote the trust shares is sometimes directly negated by statute; but such statutory provisions cannot generally apply unless both the fact of the trust and the name of the *cestui que trust* be entered on the register. In the absence of such a statute, the beneficiary is of course entitled to hold the trustee to accountability for the manner in which

¹ *Re Barker*, 6 Wend. (N. Y.) 509 11 Am. Rep. 291; *State ex rel. Ryan* (overruling dictum in *Ex parte Holmes*, 5 Cow. (N. Y.) 426). *v. Cronan*, 23 Nevada 437; 49 Pac. 41; *Commonwealth v. Dalzell*, 152 Pa. St. 217; 25 Atl. 535; 34 Am. St. Rep. 640; *Conant v. Millaudon*, 5 La. Ann. 542; *Wilson v. Central Bridge*, 9 R. I. 590.

As to so-called voting trusts, see *infra*, § 1268 *et seq.*

As to directions in deed or will creating the trust respecting the manner of exercise, see *infra*, § 1272.

² *Cannon v. Trask*, 20 Eq. 669; *Pender v. Lushington*, 6 Ch. D. 70; *Mohawk & Hudson River R. R. Co.*, 19 Wend. (N. Y.) 135; *State v. Leete*, 16 Nevada 242; *Utica Fire Alarm Telegraph Co.*, 115 N. Y. App. Div. 821.

³ *Hoppin v. Buffum*, 9 R. I. 513; N. E. 388.

Cf. Market Street Ry. v. Hellman, 109 Cal. 571; 42 Pac. 225.

⁴ See *supra*, § 988.

⁵ *Market Street Ry. Co. v. Hellman*, 109 Cal. 571, 589; 42 Pac. 225.

⁶ *North Shore, etc. Ferry Co.*, 63 Barb. 556. See *infra*, § 1227.

⁷ *Argus Co.*, 138 N. Y. 557; 34

he exercises the voting rights;¹ and in the case of a dry trust he may insist that the trustee execute to him a proxy, or power of attorney, to enable him, the absolute equitable owner, to exercise this incident of ownership.²

It has been held that where shares are registered in the name of a mere nominal owner or dummy in order to enable the beneficial owner to escape the liabilities of a shareholder, the dummy is not entitled to vote under a statute confining the privileges to registered "*bona fide* shareholders."³ Shares held in trust for the company itself cannot be voted by anybody.⁴ It follows necessarily from what has been said above that where shares are registered in the name of "J., Cashier," J's resignation as cashier and the election of C as his successor does not entitle C to vote in respect of the shares.⁵

§ 1224. **Shares subject to Pledge or Mortgage.** — As between mortgagor and mortgagee, pledgor and pledgee, the difficulty of determining who is entitled to vote is enhanced by the ambiguity of the terms as applied to shares.⁶ On principle, when a transfer of shares is registered in the name of the creditor, the latter becomes the legal owner even though the transfer is intended merely as security for the debt, and as such owner he should be entitled to vote in respect of the hypothecated shares;⁷

¹ See *United Gold, etc. Co. v. Ry. Co.*, 115 Cal. 584; 47 Pac. 582; *Smith*, 44 N. Y. Misc. 567; 90 N. Y. Supp. 199; *Re Hirsch*, 116 N. Y. App. Div. 367 (where the trustee was removed partly on account of using the trust shares to elect himself to an office of pecuniary emolument). See *infra*, § 1497.

² *American National Bank v. Oriental Mills*, 17 R. I. 551; 23 Atl. 795; *Vowell v. Thompson*, 3 Cranch C. C. 428.

See also *Argus Printing Co.*, 1 N. Dak. 434, 446, 448; 48 N. W. 347; 26 Am. St. Rep. 639; *Hoppin v. Buffum*, 9 R. I. 513; 11 Am. Rep. 291; *Pennsylvania R. Co. v. Pennsylvania Co. for Ins., etc.*, 205 Pa. St. 219; 54 Atl. 783 (where the *cestui que trust* intended to vote in favor of a merger with another corporation).

³ *Smith v. San Francisco, etc.*

Ry. Co., 115 Cal. 584; 47 Pac. 582; 56 Am. Dec. 119; 35 L. R. A. 309.

See further as to the construction of this phrase "*bona fide* stockholder": *Re Argus Printing Co.*, 1 N. Dak. 434, 448; 48 N. W. 347; 26 Am. St. Rep. 639; *Stewart v. Mahony Mining Co.*, 54 Cal. 149.

California cases on this point should be applied with caution because of the peculiar doctrines prevailing in that state, as to which see *supra*, § 1220.

⁴ See *infra*, § 1233.

⁵ *Mohawk & Hudson R. R. Co.*, 19 Wend. (N. Y.) 135.

Cf. Mousseaux v. Urquhart, 19 La. Ann. 482.

⁶ See *supra*, § 996.

⁷ *Hoppin v. Buffum*, 9 R. I. 513; 11 Am. Rep. 291; *Commonwealth v. Dalzell*, 152 Pa. St. 217; 25 Atl. 535; 34 Am. St. Rep. 640; *Vail v. Hamil-*

and this would be true as well before as after default in payment of the debt, and whether or not the transfer on the books is expressed to be by way of security. In jurisdictions, however, where the technical nature of a mortgage as a conveyance of the legal title has been lost from sight, and where a mortgage is not regarded as passing title but as merely creating a lien, a transferor of shares as collateral security, where the real nature of the transfer is communicated to the company and indicated on its books, remains the legal owner, and as such continues entitled to vote in respect of the shares. Moreover, as will be further explained below, statutes sometimes provide that the mortgagor and not the mortgagee of shares shall be entitled to vote in respect thereof.¹ Then too, the mortgagor as equitable owner or *cestui que trust* may sometimes in equity compel the mortgagee to execute to him a proxy to vote on the shares.² Where a corporation mortgages or pledges its own shares to secure its own debt, the mortgagee or pledgee cannot vote thereon,³ for somewhat the same reason that one holding shares in trust for the company has no voting rights.

Where a debtor executes a transfer of shares to his creditor and delivers the certificates endorsed in the ordinary way as collateral security for the loan, the debtor remains the absolute owner of record, and as such is clearly entitled to vote.⁴ If, however, the creditor is registered by virtue of the transfer, it would seem clear that the debtor having ceased to be the registered owner would no longer be qualified to vote.⁵ It has

ton, 85 N. Y. 453; *Utica Fire Alarm Co.*, 115 N. Y. App. Div. 821. For a peculiarity of Pennsylvania law, compare *supra*, p. 1017, n. 2, and *infra*, p. 1023, n. 5.

¹ See *infra*, § 1225.

² *Hoppin v. Buffum*, 9 R. I. 513; 11 Am. Rep. 291 (semble); *Vowell v. Thompson*, 3 Cranch C. C. 428; *Pennsylvania R. R. Co. v. Pennsylvania Co. for Ins., etc.*, 205 Pa. St. 219; 54 Atl. 783 (where the pledgor intended to use the proxy by voting in favor of amalgamation with another company).

Cf. *Haskell v. Read*, 93 N. W. 997; 96 N. W. 1007; 68 Nebr. 107.

³ *Brewster v. Hartley*, 37 Cal. 15; 99 Am. Dec. 237.

But see *contra*, *Vail v. Hamilton*, 85 N. Y. 453.

Cf. *Heath v. Silverthorn, etc. Co.*, 39 Wisc. 146.

⁴ *Ex parte Willcocks*, 7 Cow. (N. Y.) 402; 17 Am. Rep. 525; *Reynolds v. Bridenthal*, 57 Nebr. 280 (headnote inadequate); 77 N. W. 658.

See also *Re Barker*, 6 Wend. (N. Y.) 509.

⁵ *Argus Printing Co.*, 1 N. Dak. 434; 48 N. W. 347; 26 Am. St. Rep. 639; *Hoppin v. Buffum*, 9 R. I. 513; 11 Am. Rep. 291.

But see *State v. Smith*, 15 Oreg.

been held that a creditor of a company who accepts its stock as collateral security for his claim does not by voting in respect thereof become liable as for a conversion.¹

§ 1225. *Statutes providing that Pledgor or Mortgagor may vote.* — Statutes sometimes provide that the pledgor or mortgagor of shares shall be allowed to vote.² Under such a provision, a person to whom shares are conveyed in trust to secure the transferor's indebtedness to a third party is to be regarded not as a trustee but as a mere pledgee, so that the right of voting remains in the debtor.³ In truth, the transaction amounts to a deed of trust in the nature of a mortgage. Such statutes must, however, be construed as extending to cases where the name of the mortgagee or pledgee appears on the register; otherwise they would have no effect. But not even express statutes of this sort should be construed as entitling the mortgagor to vote unless his name is registered.⁴

§ 1226. **Voting Rights of Vendor and Purchaser of Shares.** — As between vendor and purchaser of shares, the rule is comparatively simple. The vendor, as registered owner, is necessarily entitled to vote until the transfer has been entered on the company's books.⁵ Until then, notwithstanding delivery of the certificate of stock properly endorsed, the vendor remains, so far as the company is concerned, the legal owner. So, the vendor is entitled to vote pending a suit for specific performance of a

98; 14 Pac. 814; 15 Pac. 137, 386 (criticised supra, § 1221).

¹ *Heath v. Silverthorn*, 39 Wisc. 146.

Cf. *Union, etc. Bank v. Farrington*, 13 Lea (Tenn.) 333.

² Cf. *Elyea v. Lehigh Salt Mining Co.*, 169 N. Y. 29; 61 N. E. 992 (holding that pledgee cannot object to a contract on the part of the company to which the pledgor had assented).

³ *Nat. Bank of Commerce v. Allen*, 90 Fed. 545, 552; 33 C. C. A. 169.

⁴ *Wentworth Co. v. French*, 176 Mass. 442; 57 N. E. 789; *Canadian Imp. Co. v. Lea* (N. J.), 69 Atl. 455.

⁵ *Argus Co.*, 138 N. Y. 557, 579; 34 N. E. 388; *People v. Tibbets*, 4 Cow. (N. Y.) 358; *People ex rel.*

Probert v. Robinson, 64 Cal. 373; 1 Pac. 156.

See also *State v. Pettineli*, 10 Nevada 141, 144 (a case of a gift of shares); *Third Nat. Bank v. Jackson*, 156 Fed. 144 (a case of a deed of trust for benefit of creditors).

In Pennsylvania the rule prevails that the right to vote as between vendor and vendee, mortgagor and mortgagee, and the like, depends on the agreement of the parties and not upon which party has become the registered owner. *Commonwealth v. Patterson*, 158 Pa. St. 476; 27 Atl. 998; *Commonwealth v. Dalzell*, 152 Pa. St. 217; 25 Atl. 535; 34 Am. St. Rep. 640; *Commonwealth v. Woodward*, 4 Phila. 124. Cf. supra, p. 1017, n. 2.

contract for the sale of shares.¹ Indeed, a by-law attempting to prevent a transferor from voting, where a transfer was executed but not registered before the meeting, is void.² In Illinois, in the absence of any regulation making shares transferable on the books of the company, it was held that a vendee becomes entitled to vote immediately on the endorsement to him of the share-certificate.³ And even under the prevailing rule, the vendor has no right to vote, as between himself and the vendee, after the delivery of the certificate, and if he do so to the injury of the purchaser, the latter has a cause of action against him in the nature of a claim for tort.⁴

§ 1227. **Shares transmitted by Death, Bankruptcy, etc., of Shareholder.** — In cases of transmission of shares by operation of law the same rule prevails. Thus, where a shareholder becomes bankrupt, he nevertheless remains entitled to vote on his shares until the assignee in bankruptcy is registered as a member, and that, too, although the Bankrupt Act vests the assignee with title to all the bankrupt's property.⁵ But in case of death, the executor or administrator of a registered owner has been held entitled to vote on production of his letters without any formal entry on the books;⁶ and in case of a non-resident shareholder this rule has been applied where the administration was in a foreign court — in a court of the deceased's domicile.⁷ So, it seems, a surviving partner may vote upon stock registered in the name of the firm.⁸

§ 1228. **Co-owners of Shares — Co-executors, Co-trustees, etc.** — Where shares are registered in the name of several persons as co-owners, it seems that all must concur in the vote, other-

¹ *Lucas v. Milliken*, 139 Fed. 816.

² *People v. Tibbets*, 4 Cow. (N. Y.) 358.

³ *People v. Devin*, 17 Ill. 84.

Cf. *Commonwealth v. Woodward*, 4 Phila. 124.

⁴ *Witham v. Cohen*, 100 Ga. 670; 28 S. E. 505 (holding that damages in such a case may include loss of the salary of an office to which the purchaser would otherwise have been elected).

⁵ *State v. Ferris*, 42 Conn. 560.

⁶ *Market Street Ry. Co. v. Hell-*

man, 109 Cal. 571, 590; 42 Pac. 225; *Cape May, etc. Nav. Co.*, 51 N. J. Law 78; 16 Atl. 191; *North Shore, etc. Ferry Co.*, 63 Barb. 556 (as to which last case see *supra*, § 1223).

See also *Schmidt v. Mitchell*, 101 Ky. 570; 41 S. W. 929; 72 Am. St. Rep. 427. Cf. *supra*, § 976.

⁷ *Cape May, etc. Nav. Co.*, 51 N. J. Law 78; 16 Atl. 191.

⁸ *Kenton Furnace, etc. Co. v. McAlpin*, 5 Fed. 737, 748-749; *Allen v. Hill*, 16 Cal. 113.

wise the shares cannot be voted. Thus, two out of three executors have no power to vote in opposition to the wishes of their colleague.¹ *A fortiori* where two co-owners disagree, the shares cannot be voted.² Fractional votes by owners of fractions of a share are not permissible.³ But where shares are held by three co-executors, any one of them who is present at the meeting may, it seems, vote in respect of the shares belonging to the estate, unless his colleagues object.⁴ And the same rule applies as to shares owned by co-partners.⁵ Where shares are owned by two or more trustees, it is their duty to agree, and a wilful disagreement for the purpose of preventing a vote in respect of the shares is a breach of trust.⁶

§ 1229. **Alien Shareholders.**— Unless expressly prohibited, an alien friend may become the owner of shares in a domestic corporation, and that too although the original corporators are required to be citizens; and as a matter of course an alien lawfully owning shares is entitled to vote in respect thereof.⁷ But an express statute may prohibit alien stockholders from voting, and in that case the law cannot be evaded by putting the stock in the name of a resident who, however, is really trustee for the non-resident.⁸

§ 1230. **Infant Shareholders.**— The opinion has been rather tentatively expressed that an infant who is a member of a corporation has the same right to vote as an adult. "There would seem to be no legal obstacle in the way of minors taking part in corporate meetings consulting, advising, or even voting."⁹ The right to vote as shareholder in business corporations is, however, in the nature of a property right, and therefore should be exercised by the guardian rather than by the infant in person.

¹ *Tunis v. Hestonville, etc. R. R. Co.*, 149 Pa. St. 70; 24 Atl. 88; 15 L. R. A. 665.

As to cases where a will directs that the executors shall execute a proxy to one of their number, see *infra*, § 1272.

² *Pioneer Paper Co.*, 36 How. Pr. (N. Y.) 111.

Cf. *Villamill v. Hirsch*, 138 Fed. 690; 143 Fed. 654.

³ *Provident Bldg. & Loan Ass.*, 62 N. J. Law 590; 41 Atl. 952.

⁴ *Schmidt v. Mitchell*, 101 Ky. 570; 41 S. W. 929; 72 Am. St. Rep. 427.

⁵ *Kenton Furnace, etc. Co. v. McAlpin*, 5 Fed. 737, 747-748.

⁶ *Re Elias*, 40 N. Y. Supp. 910; 17 N. Y. Misc. 718.

⁷ *Commonwealth v. Detwiller*, 131 Pa. St. 614; 18 Atl. 990; 7 L. R. A. 357.

⁸ *State v. Hunton*, 28 Vt. 594.

⁹ *Chicago Mut. Life, etc. Ass'n v. Hunt*, 127 Ill. 257, 278.

§ 1231. **Shares owned by a Corporation.**—In general, it seems clear that any corporation having the right to purchase shares in another company may also vote in respect of the shares which it owns.¹ But if a corporation assumes *ultra vires* to acquire shares in another corporation, the former company, while perhaps entitled to sell and dispose of the shares, or to collect the dividends thereon during its unlawful ownership, will be enjoined from voting in respect thereof at the meetings of the latter company.² This same rule has been applied in cases where the ownership of the stock is not so much *ultra vires* as illegal, because of the *quo animo*, or because of some tendency towards restraint of trade, or for some other similar reason.³ And some cases at least *tend* toward holding that even where a company's ownership of shares in another corporation is lawful and proper, the ownership is "imperfect," and does not carry the right to vote;⁴ but this is contrary to what has already been stated as the sound and prevalent doctrine.

¹ *Rogers v. Nashville, etc. Ry. Co.*, 91 Fed. 299; 33 C. C. A. 517; *Oelbermann v. N. Y., etc. Ry. Co.*, 77 Hun (N. Y.) 332; 29 N. Y. Supp. 545; *Clarke v. Richmond, etc. Co.*, 62 Fed. 328; 10 C. C. A. 387; *Am. Refrigerating, etc. Co. v. Linn*, 93 Ala. 610; 7 So. 191; *Davis v. U. S. Electric, etc. Co.*, 77 Md. 35; 25 Atl. 982; *Market Street Ry. Co. v. Hellman*, 109 Cal. 571, 589; 42 Pac. 225.

As to the case where one corporation controls another company which owns stock of the first corporation, see *infra*, § 1233.

² *Milbank v. New York, etc. R. R. Co.*, 64 How. Pr. (N. Y.) 20.

Cf. *Parsons v. Tacoma Smelting, etc. Co.*, 65 Pac. 765; 25 Wash. 492; *Coler v. Tacoma Ry., etc. Co.*, 65 N. J. Eq. 347; 54 Atl. 413; 103 Am. St. Rep. 786 (holding that New Jersey corporation having power to acquire shares in other companies cannot vote as a shareholder in a Washington corporation when by the policy of the last mentioned state one corporation is forbidden

to vote as shareholder in another corporation).

³ *Clarke v. Central R. R., etc. Co.*, 50 Fed. 338; 15 L. R. A. 683 (with which compare *Clarke v. Richmond, etc. Co.*, 62 Fed. 328; 10 C. C. A. 387); *Memphis, etc. R. R. Co. v. Woods*, 88 Ala. 630; 7 So. 108; 16 Am. St. Rep. 81; 7 L. R. A. 605 (where it seemed to be thought that any voting on shares owned by a competing company should be restrained); *George v. Central R. R., etc. Co.*, 101 Ala. 607; 14 So. 752; *Dunbar v. Am. Tel., etc. Co.*, 79 N. E. 423, 428-430; 224 Ill. 9 (where the plaintiff was a shareholder in the company in which the defendant corporation held shares); *Bigelow v. Calumet, etc. Mining Co.*, 155 Fed. 869 (similar to last case).

Cf. *Am. Refrigerating, etc. Co. v. Linn*, 93 Ala. 610; 7 So. 191.

⁴ *State ex rel. Jackson v. Newman*, 51 La. Ann. 833; 25 So. 408; 72 Am. St. Rep. 476; *Memphis, etc. R. R. Co. v. Woods*, 88 Ala. 630; 7 So. 108; 16 Am. St. Rep. 81; 7 L. R. A. 605.

§ 1232. *Municipal Corporation having statutory Power to appoint some Directors.* — Where shares are held by a municipal corporation, which by statute is given the right of appointing some of the directors, it has nevertheless all the voting rights of an ordinary shareholder, and may therefore vote even at the election of the remaining members of the board.¹

§ 1233. *Shares owned by the Company itself.* — Where a company makes a valid purchase of some of its own shares, as under the law of some states it may do, or where by any lawful means, — such as forfeiture or surrender, — the company becomes the owner of some of its own shares, the shares so acquired are temporarily merged and extinguished,² and consequently the corporation itself cannot vote in respect of them. Similarly, where shares in a corporation are held in trust for the company itself, the trustee cannot vote in respect of them,³ and of course the company or *cestui que trust* cannot do so;⁴ consequently shares so held cannot be voted by anybody.⁵ Indeed, where a corporation acquires the entire capital stock of another company which is the owner of some shares in the first company, the directors of the first company cannot at a meeting of their own company vote in respect of the shares so owned by the other company.⁶ Moreover, according to one view, shares issued by the company as collateral security for its own debt cannot be voted upon.⁷

§ 1234. *Shares Title to which has been adjudicated.* — When the ownership of shares has been the subject of a judgment, the person whose title is thus judicially established is entitled to vote even pending an appeal by which the operation of the judgment is stayed.⁸

¹ *State v. New Orleans, etc. R. R.* 398; *State ex rel. Page v. Smith*, 48 Co., 20 La. Ann. 489, 494 (headnote inadequate). Vt. 266 (semble).

² See supra, § 633.

³ *Mousseaux v. Urquhart*, 19 La. Ann. 482 (headnote misleading).

⁴ *U. S. v. Columbian Ins. Co.*, 2 Cranch C. C. 266.

⁵ *McNeely v. Woodruff*, 13 N. J.

Law 352, 360; *Ex parte Holmes*, 5 Cow. (N. Y.) 426 (headnote misleading); *Brewster v. Hartly*, 37 Cal. 15; 99 Am. Dec. 237; *American Ry. Frog Co. v. Haven*, 101 Mass.

⁶ *O'Connor v. International Silver Co.*, 59 Atl. (N. J.) 321, affirmed on somewhat different grounds, 62 Atl. 408.

⁷ See supra, § 1224.

⁸ *Pioneer Paper Co.*, 36 How. Pr.

111.

As to *res judicata* as affecting the right to vote as owner of shares, see further *Leigh v. National Hollow, etc. Co.*, 79 N. E. 318; 224 Ill. 76.

§ 1235. **Proxies for qualified Voters.** — The right of a proxy to vote as the representative of the qualified voter is the subject of detailed consideration below.¹

§ 1236. **At what Point of Time Voter must be qualified.** — The shareholder's right to vote is ordinarily to be judged as of the date when the meeting is actually held. Sometimes, however, it is provided that only those shareholders shall vote who might have voted at the time the meeting ought to have been held. Another not infrequent provision is that the voter must have held his shares for a certain time prior to the meeting. Such a provision in a statute is valid although the state constitution declare that every shareholder shall have a vote;² and by parity of reasoning such a provision in the by-laws or other regulations of the company would be good even if a statute confer the right to vote on shareholders generally.

§ 1237. **Waiver of Right to Vote — Preferred Shares.** — A mere private agreement by one stockholder with another not to exercise his right to vote, although possibly valid *inter partes*,³ should not, according to the better view, bind the corporation not to receive his vote;⁴ but upon an issue of shares a stipulation may be entered into and made a part of the terms of issue that the holders of some or all of the shares so to be issued shall have no right to vote, or, more accurately, shall waive their right to vote; and this stipulation or waiver will become part of the very nature of such shares, and will be valid not only as between the shareholders but also as regards the corporation, and indeed all the world.⁵

§ 1238. **Contracts to vote in a particular Way or as other Persons may dictate.** — The argument may be made that public policy prohibits a contract by which a shareholder parts with his right to vote for a consideration — in other words, sells his

¹ *Infra*, § 1252 et seq.

² *Re Vernon*, 1 Pennewill (Del.) 202, 207-208 (headnote inadequate); 40 Atl. 60.

³ As to agreements respecting the exercise of the right to vote, see *infra*, § 1238.

⁴ See *infra*, § 1266(d).

⁵ Cf. *Miller v. Ratterman*, 47 Oh. St. 141; 24 N. E. 496; *State ex rel. Frank v. Swanger*, 89 S. W. 872;

190 Mo. 561. Lurton, J., said in reference to such a provision, "That was perhaps a valid agreement between stockholders although of doubtful public policy," *Hamlin v. Toledo, etc. R. R. Co.*, 78 Fed. 664, 671; 24 C. C. A. 271; 36 L. R. A. 826. See also the subject of preferred shares, *supra*, § 570, where the question is more fully discussed.

vote. Now, although the law is generally settled that a shareholder is not a fiduciary and is not debarred from voting because of some personal interest other than his interest in the success of the company's undertaking, yet the courts will certainly look askance at any out-and-out sale of a shareholder's vote.¹ Thus, an agreement by a shareholder to vote in favor of an increase in the salary of the company's manager in consideration of the payment of a sum of money to him by the latter cannot be sued upon:² it is illegal and against public policy. Such contracts by executors or trustees have been held to be objectionable for the further reason that a fiduciary has no right to divest himself of complete control over the trust estate.³ So, it has been held that a contract between two holders of lucrative offices under the company whereby they agree to co-operate in canvassing the company so as to secure enough votes to secure their own reelection is invalid.⁴

On the other hand, public policy clearly does not prohibit shareholders from acting in concert, by "pooling" their shares or otherwise, for what they may deem the company's best interests.⁵ Agreements, therefore, between shareholders to vote

¹ See *Germicide Co.*, 65 Hun (N. Y.) 606; 20 N. Y. Supp. 495 (arising under a New York statute explicitly forbidding the giving of a proxy for a consideration or the sale of his vote by a shareholder); *Elliot v. Richardson*, L. R. 5 C. P. 744 (where the agreement was doubly objectionable because the company was being wound up by the court).

But see *Greenwell v. Porter* (1902), 1 Ch. 530 (contract by a shareholder to vote for a certain person as director held valid).

² *Woodruff v. Wentworth*, 133 Mass. 309.

For other applications of the same principle, see *Guernsey v. Cook*, 120 Mass. 501; *Noyes v. Marsh*, 123 Mass. 286 (semble); *Cone v. Russell*, 48 N. J. Eq. 208; 21 Atl. 847; *Gage v. Fisher*, 5 N. Dak. 297; 65 N. W. 809; 31 L. R. A. 557.

Cf. *Snow v. Church*, 13 N. Y. App. Div. 108; 42 N. Y. Supp. 1072; *Bradley v. Carritt* (1903), A. C. 253

(where such a contract was held void as clogging an equity of redemption, no reference being made to the principle stated in the text).

Where the shareholder making such an agreement is also a director, the contract is still more clearly illegal. See *infra*, § 1632, § 1633.

³ *Cone v. Russell*, 48 N. J. Eq. 208; 21 Atl. 847.

But see *Greenwell v. Porter* (1902), 1 Ch. 530.

⁴ *Withers v. Edwards*, 62 S. W. 795; 26 Tex. Civ. App. 189.

⁵ *Tomlin v. Farmers', etc. Bank*, 52 Mo. App. 430; *Smith v. San Francisco, etc. Ry. Co.*, 115 Cal. 584; 47 Pac. 582; 56 Am. St. Rep. 119; 35 L. R. A. 309; *Moses v. Scott*, 84 Ala. 608; 4 So. 742 (semble); *Chapman v. Bates*, 61 N. J. Eq. 658; 47 Atl. 638; 88 Am. St. Rep. 459; *Faulds v. Yates*, 57 Ill. 416; 11 Am. Rep. 24; *Havemeyer v. Havemeyer*, 43 N. Y. Super. Ct. 506 (with which

in a certain way are not necessarily invalid. If supported merely by mutual promises, or by any other good and lawful consideration tending only to the advancement of the corporation, an agreement with fellow shareholders to vote in a particular manner may be sued upon at law,¹ or may probably be specifically enforced in equity.²

Of course, however, such agreements will not bind a purchaser of the shares who has no notice thereof, and in Alabama will not be enforceable even against a vendee with notice, because a contrary result would, it is thought, amount to such a restraint on alienation as to violate public policy³ — an opinion in which it is difficult to concur.⁴

In New Jersey an agreement of this sort may be valid if all the shareholders assent,⁵ as indeed would probably be everywhere held,⁶ but becomes void as soon as shares are subscribed by persons not parties to it, whether or not they have knowledge thereof.⁷

An agreement not to vote by proxy has been pronounced illegal and void;⁸ but doubtless such a contract stands on the same footing as an agreement to vote in some particular way.

At all events, an agreement to vote or not to vote in a particular way is at worst unenforceable, and if executed cannot invalidate the election or resolution held or passed at the meeting.⁹

§ 1239. **Power of Company to fix other or additional Qualifications for Voters.** — Where a statute confers the right of voting

compare *s. c.*, 45 N. Y. Super. Ct. 464; 86 N. Y. 618; *Weber v. Della*, etc. Co. (Idaho), 94 Pac. 441.

¹ *Bonta v. Gridley*, 77 N. Y. App. Div. 33; 78 N. Y. Supp. 961.

² Cf. *Hey v. Dolphin*, 92 Hun (N. Y.) 230; 36 N. Y. Supp. 627.

But see *Gage v. Fisher*, 5 N. Dak. 297; 65 N. W. 809; 31 L. R. A. 557.

In *Converse v. Hood*, 149 Mass. 471; 21 N. E. 878; 4 L. R. A. 521, an injunction against violating an alleged agreement of the sort was refused because the contract was not proved.

³ *Moses v. Scott*, 84 Ala. 608, 612; 4 So. 742.

Cf. *Fisher v. Bush*, 35 Hun (N. Y.) 641.

⁴ See *Williams v. Montgomery*, 148 N. Y. 519; 43 N. E. 57.

⁵ *White v. Thomas Tire Co.*, 52 N. J. Eq. 178, 185-186; 28 Atl. 75.

See query in *Woodruff v. Wentworth*, 133 Mass. 309, 314.

⁶ *Kantzler v. Bensinger*, 214 Ill. 589, 598; 73 N. E. 874.

⁷ *White v. Thomas Tire Co.*, 52 N. J. Eq. 178, 187; 28 Atl. 75.

⁸ *Fisher v. Bush*, 35 Hun (N. Y.) 641.

⁹ *Tomlin v. Farmers', etc. Bank*, 52 Mo. App. 430; *Warren v. Pim*, 59 Atl. 773; 66 N. J. Eq. 353.

on the shareholders, the board of directors has no power to confer the right on any one not a shareholder, and therefore cannot grant it to one who holds stock as mortgagee of the company.¹ And in the same way, when a statute provides that the directors shall be elected by the shareholders, "and shall not be elected in any other manner," it is *ultra vires* of the corporation to confer a right to vote for directors on the bondholders; and hence any attempt to do so by contract or by-law is wholly nugatory, even though the stockholders have subscribed on that understanding and have acquiesced in the arrangement, so that a person elected as director by the votes of bondholders is not entitled to the office.² Conversely, where statutes prescribe the qualifications of voters at corporate meetings, the corporation has no power by by-law to add to those qualifications so as to disfranchise persons permitted to vote by the statute.³ Hence, a by-law prohibiting a member who is delinquent in paying his dues from voting is invalid.⁴ Statutes sometimes confer, or empower the company to confer, the right of voting on non-members — notably creditors.⁵

§ 1240. **Number of Votes necessary to pass a Resolution.** — A majority of the members present, provided they be a quorum and

¹ *Brewster v. Hartley*, 37 Cal. 15, of the right to vote." 155 Ill. 24; 99 Am. Dec. 237. Cf. *supra*, 364.

§ 1224.

² *Durkee v. People*, 155 Ill. 354; 40 N. E. 626; 46 Am. St. Rep. 340. Such arrangements should be distinguished from attempts by the shareholders to confer on bondholders the right of voting *in their stead*. Said Cartwright, J., in the case last cited: "It is suggested that this contract might be operative to confer upon bondholders an equitable right to vote the shares of stock; but it is sufficient to say respecting that claim that such was not the contract. The contract was that they might vote as bondholders, and there was no intention of depriving stockholders

Cf. *Mobile, etc. R. R. Co. v. Nicholas*, 98 Ala. 92; 12 So. 723.

³ *St. Luke's Church v. Matthews*, 4 Desaus. (S. Car.) 578, 585 (headnote inadequate); 6 Am. Dec. 619; *People ex rel. Hart v. Phillips*, 1 Denio (N. Y.) 389; *People v. Tibbets*, 4 Cow. (N. Y.) 358; *People v. Kip*, 4 Cow. (N. Y.) 382 n.

Cf. *Rex v. Cutbush*, 4 Burr. 2204 (headnote inadequate).

⁴ *Kinnan v. Sullivan County Club*, 26 N. Y. App. Div. 213; 50 N. Y. Supp. 95.

Contra, *Commonwealth v. Cain*, 5 S. & R. (Pa.) 510.

⁵ *State v. McDaniel*, 22 Oh. St. 354.

unless a heavier preponderance be expressly required by statute or the company's regulations, determines the action of the meeting.¹ Indeed, a majority of those voting is enough, although less than a majority of those present.² Where a statute requires a majority of those present, a member who is present but declines to vote cannot be treated as constructively absent.³ Where a vote of the holders of some fixed proportion, say two thirds, of the shares is required, the meaning is two thirds of the shares outstanding, — that is, excluding shares held by the company itself⁴ or shares not yet issued.⁵ Although the general presumption of law is in favor of regularity, yet where a three-fourths vote of all the shareholders is required for the passage of a particular resolution, no such resolution will be upheld, according to a Massachusetts case, unless the requirement affirmatively appear to have been complied with, evidence that more than three fourths were present at the meeting without proof of how many of those in attendance voted in favor of the resolution being insufficient;⁶ but with, it is submitted, better reason, a contrary principle has been acted upon in other states.⁷ So, where three fourths of the members present are required in order to amend the by-laws, if the records show that an amendment was carried by three fourths of the members voting, the court will presume that all the members present voted, so as to sustain the validity of the amendment.⁸

§ 1241. "*Special Resolutions*" and "*Extraordinary Resolutions*" in English Law. — The terms "special resolution" and "extraordinary resolution" are of frequent occurrence in the

¹ *Rapid Transit Ferry Co.*, 15 N. Y. App. Div. 530; 44 N. Y. Supp. 539. *man*, 109 Cal. 571, 588; 42 Pac. 225.

² *State v. Chute*, 34 Minn. 135; 24 N. W. 353. Cf. *Columbia Bottom Levee Co. v. Meier*, 39 Mo. 53.

As to the effect of votes cast for an ineligible candidate, see *infra*, § 1287.

³ *Commonwealth v. Wickersham*, 66 Pa. St. 134; As to the effect of a blank vote, compare *Murdoch v. Strange*, 99 Md. 89.

⁴ *Green v. Seymour*, 3 Sandf. Ch. (N. Y.) 285.

⁵ *Market Street Ry. Co. v. Hell-*

⁶ *Am. Tube Works v. Boston Machine Co.*, 139 Mass. 5, 10; 29 N. E. 63.

⁷ *Heintzelman v. Druids Relief Ass'n*, 38 Minn. 138; 36 N. W. 100; *Marsh v. Mathias*, 19 Utah 350 (headnote inadequate); 56 Pac. 1074.

Cf. *Cuykendall v. Douglas*, 19 Hun (N. Y.) 577; *Man v. Boykin*, (S. Car.), 60 S. E. 17 (headnote inadequate).

⁸ *Cowan v. Caledonian Club*, 61 N. Y. Supp. 714; 46 N. Y. App. Div. 288.

English books. In order to take effect as a "special resolution," a resolution must have been passed by a three-fourths vote at some general meeting of the company convened for that purpose, and must have been confirmed by a majority vote at a subsequent general meeting held not less than fourteen days nor more than one month after the former meeting.¹ A resolution so passed and confirmed is capable of effecting a number of objects that could be compassed in no other way — such as an increase or reduction of capital, a change of name, etc. An "extraordinary resolution" is a resolution "which is passed in such manner as would, if it had been confirmed by a subsequent meeting, have constituted a special resolution as hereinbefore defined."² An extraordinary resolution is requisite in order to go into voluntary liquidation and for some other purposes. A comprehension of the meaning of these terms is necessary to a thorough understanding of many important English cases; but as nothing of precisely the same nature exists in the United States, an examination of the English decisions that bear only on the nature, requisites, and necessity of such resolutions is superfluous.

§ 1242. **Effect of Vote upon Voter's Individual Rights.** — A shareholder's vote in favor of any resolution operates, according to a dictum in a New York case, as an individual consent to the action resolved upon, and therefore prevents him from subsequently objecting that such action infringes his individual rights, under a contract with the company or otherwise.³ On the other hand, the Supreme Court of Canada has held that where two persons have executed a lease to a corporation in which they are large shareholders, the fact that as shareholders they propose and vote for a resolution authorizing an assignment of the term does not prevent them as lessors from enforcing a forfeiture on account of the assignment.⁴ The ground of the decision was that the corporation was a legal entity distinct from the shareholders — a legal proposition which no lawyer would care to impugn, but which, it is submitted, does not justify the decision.

¹ Companies Act, 1862, § 51.

⁴ *Soper v. Littlejohn*, 31 Can. Sup.

² Companies Act, 1862, § 129.

Ct. 572. Cf. *Glass v. Pioneer Rub-*

³ *Hix v. Edison Electric Co.*, 10 N. Y. App. Div. 75, 85; 41 N. Y. Supp. 680 (semble).

ber Works, 31 Viet. L. R. 754 (criticised infra, § 1606).

The question was not whether a corporation is an entity distinct from that of its members, but whether a shareholder is split up into two personalities, so that action taken by him as a member of the corporation cannot affect his rights as a landowner.

§ 1243-§ 1279. PROCEDURE AT SHAREHOLDERS' MEETINGS.

§ 1243. **Motions, Amendments, etc., in general.** — The procedure at shareholders' meetings is apt to be informal to a degree. This fact renders it all the more important to inquire what amount of informality will be tolerated. A corporation may in its regulations or by-laws adopt the rules of procedure laid down in "Cushing's Manual" or other treatise on parliamentary law;¹ but in the absence of such express adoption one cannot safely assume that company meetings are governed by the principles stated in such works. Convenience certainly urges that all principal motions shall be put in the shape of formal written resolutions; but this is by no means necessary.² A motion or resolution may be oral; or, indeed, if one's meaning is understood, no formal motion at all is necessary.³ If an amendment to a motion is duly offered, the chairman should put the amendment to a vote before taking a vote on the main question; and if he decline to do so, ruling the amendment out of order, the passage of the original resolution is illegal and void.⁴ Although the ordinary rules of parliamentary procedure require that all resolutions shall be seconded, yet where a motion is put to a vote and carried, it is immaterial that it was never seconded.⁵ A vote approving the minutes of a former meeting which state that such and such a resolution was there passed has been held to be equivalent to a new vote passing such resolution, although the entry in the minutes was false.⁶

¹ *People v. American Inst.*, 44 How. Pr. 468.

Cf. *Gipson v. Morris*, 83 S. W. 226; 36 Tex. Civ. App. 593.

² See *supra*, § 1118.

³ *Henderson v. Bank of Australasia*, 45 Ch. D. 330.

⁴ *Henderson v. Bank of Australasia*, 45 Ch. D. 330.

⁵ *Horbury Bridge Co.*, 11 Ch. D. 109, 117.

⁶ *Delano v. Smith Charities*, 138 Mass. 63.

But see *Davis Mill Co. v. Bennett*, 39 Mo. App. 460; *Ohio Valley Nat. Bank v. Walton Architectural Iron Co.*, 30 Wkly. Law Bull. (Oh.) 382. Cf. *infra*, p. 1217, n. 1, and § 1545.

A vote of some kind, however, is essential to valid affirmative action. Thus, where the chairman states a proposition and says, "If there is a single person present who is dissatisfied with this, I wish you to say so fully and frankly," and after a silence some one remarks, "It is clear that we are all of one mind in this matter," there is no effectual approval of the proposition.¹

§ 1244. **Regulations as to Order of Business.** — Regulations prescribing the order of business at shareholders' meetings should generally be construed as directory merely. Thus, where the charter provides that the shareholders shall first adopt by-laws and then elect directors, an election of directors is not invalid because by-laws were not first adopted.² So, where a statute provides that the president of the company shall be chosen "out of" the directors, the election of a president is not invalid because he has not been first chosen a director.³

§ 1245. **Regulations as to Date for Transaction of certain Business.** — Indeed, a provision requiring certain business, such as the election of directors, to be transacted on a specified day has been held to be merely directory, so that, if the matter is not then attended to, it may properly be taken up on a later day.⁴ But on the other hand the Supreme Court of Alabama has decided that where the election of directors is required to be held at the annual meeting of shareholders it cannot be held at any subsequent special meeting.⁵

§ 1246-§ 1272. METHODS OF VOTING.

§ 1246. **By Ayes and Noes or by Show of Hands.** — Some diversity of opinion has existed, especially in England, as to the mode of voting at shareholders' meetings. The simplest and most informal method of voting is *viva voce*, by ayes and noes. Another method, somewhat more accurate and almost equally

¹ *Landers v. Frank Street M. E. ker*, 20 N. H. 58; *Re Hammond*, 139 *Church*, 114 N. Y. 626 (headnote inadequate); 21 N. E. 420. Cf. *People v. Runkle*, 9 Johns. Fed. 898, 899-900.

² *Hughes v. Parker*, 19 N. H. 181. (N. Y.) 147.

³ *Currie v. Mutual Ass. Soc.*, 4 Hen. & Munf. (Va.) 315; 4 *Am. Soc.*, 76 Ala. 567. Dec. 517. But see *Weatherby v. Medical, etc.*

⁵ *Moses v. Tompkins*, 84 Ala.

⁴ *Beardsley v. Johnson*, 121 N. Y. 613; 4 So. 763. Cf. *infra*, § 1401. 224; 24 N. E. 380; *Hughes v. Par-*

expeditious, is by show of hands. When each shareholder has but one vote, either of these methods would tend to the same result as a formal poll, a numerical majority of the members always prevailing; and the only reason for demanding a poll is to secure greater certainty and deliberation. But where, by law or the constitution of the company, the ordinary modern rule prevails, and each member is entitled to as many votes as he holds shares, either of the methods above referred to is very unsatisfactory as a final determination of the question, since either of them enables a numerical majority to outvote a smaller number of members holding a larger number of shares.¹ Moreover, on a show of hands a person holding proxies for several members is entitled to but one vote.² In order to give the holders of large blocks of shares the number of votes to which they are entitled, and to give full effect to proxies, some mode of voting other than by ayes and noes, or by show of hands, must be adopted.

§ 1247. *Of the Rule that a Vote must be taken in the first Instance by Ayes and Noes or by Show of Hands.* — The English rule is, however, that even where proportionate voting is the law of the company, the vote must be taken in the first instance by show of hands,³ upon which, of course, a numerical majority prevails. If no poll is legally demanded, the result of the show of hands will stand as the vote of the meeting, even though the side thus prevailing hold fewer shares than their opponents.⁴ Much may be said on the score of convenience in favor of thus requiring a preliminary vote by show of hands. For under any possible system considerable time must be consumed in determining the number of shares to which each voter may be entitled; and if the process must be gone through with on all the numerous petty questions that are likely to arise at any meeting, an intolerable prolongation of the proceedings is likely to result. The English rule is, therefore, reasonable in itself, and only becomes objectionable when taken in connection with the illib-

¹ Cf. *Wardens of Christ Church v. Pope*, 8 Gray (Mass.) 140, 143.

³ *Horbury Bridge Co.*, 11 Ch. D. 109; *Ernest v. Loma Gold Mines*

² *Ernest v. Loma Gold Mines* (1897), 1 Ch. 1, 7 (semble).

(1897), 1 Ch. 1; *Caloric Engine Co.*, 52 L. T. 846.

⁴ *Horbury Bridge Co.*, 11 Ch. D. 109.

Contra, *Re Bidwell Bros.* (1893), 1 Ch. 603.

eral doctrines that seem to have become established in that country with respect to the right of demanding a poll.¹ For the vote by show of hands should be regarded as a mere preliminary determination which is to stand only in case no objection is raised.

Preliminary votes by ayes and noes are governed by the same rules as preliminary votes by show of hands.

§ 1248. **Voting by Ballot.** — A vote by ballot is more formal than by ayes and noes or by show of hands, but is open to the same objections, unless each shareholder should be allowed and required to deposit as many ballots as he holds shares — a very cumbrous proceeding. The essence of a vote by ballot is a secret vote by means of a written or printed sign;² and on the ordinary questions that come before a shareholders' meeting, a secret vote is not desirable. Only in elections for directors and other officers does any real reason for voting by ballot exist. Statutory provisions requiring all elections of directors, etc., to be by ballot are not infrequent in the United States; but of course these statutes do not require votes on other matters to be by ballot. Moreover, these statutes should probably be construed merely as requiring a written or printed, as distinguished from an oral, vote.³ The shareholders have the right to prescribe the form of ballot, and to enact that no ballot shall be counted that has on it anything besides the names of the candidates voted for.⁴ Where the election is by ballot, the inspectors have no right after the ballots are opened to reject votes cast by unqualified persons and received without challenge or objection; their only duty then is to count all ballots that are fair on their face.⁵ A ballot for directors which on its face fails to indicate how many votes are cast for each person named therein has been held to be a nullity where cumulative voting is the law of the company.⁶

¹ See *infra*, § 1251.

² Voting by ballot is sometimes used to denote a vote in writing as distinguished from *viva voce*, but this is believed to be an inaccurate use of language. "The vote given at these corporate elections, whether given in writing or *viva voce*, is always essentially an *open* as distinguished from a *secret* vote," *State*

v. ex rel. Lawrence v. McGann, 64 Mo. App. 225.

³ See last note.

⁴ *Commonwealth v. Woelper*, 3 Serg. & R. (Pa.) 29; 8 Am. Dec. 628.

⁵ *People v. White*, 11 Abb. Pr. (N. Y.) 168, 179 (semble).

⁶ *P. B. Mathiason Mfg. Co. (Mo.)*, 99 S. W. 502.

§ 1249. **Voting by "Polling Papers."** — A vote by "polling paper" to be filled up and signed by the shareholder at his leisure and lodged at the company's office is distinguishable from a vote by ballot. Such a method of voting is impossible where the regulations of the company provide that only shareholders who are present in person or by proxy shall have a vote; for such a vote cannot be deemed a vote in person, and yet the "polling paper" cannot be deemed a proxy.¹ Consequently, even where the regulations empower the chairman to direct the time, place and manner of a poll, the chairman cannot authorize the use of such "polling papers."²

§ 1250. **Polls — Nature of a Poll.** — The only thoroughly satisfactory method of carrying out the principle of proportionate voting is by means of a poll. At a poll, each voter satisfies the secretary or some other officer of his registered ownership of so many shares, or produces a proxy from such registered owner, whereupon the secretary or other officer records the number of votes to which he may be entitled, in favor of or against the proposition before the meeting. In England a poll seems to be a much more solemn transaction than with us; and only after dicta to the contrary³ have the English courts finally decided that a poll may be taken immediately, at the same meeting at which it is demanded.⁴ In America no doubt upon that question would ever have been entertained.⁵ Indeed, the well-nigh universal practice is to take the poll instanter, and often without any formal demand, and on any question of importance it is customary to have a poll at once, without any preliminary vote by show of hands. A poll is not rendered irregular because an adjournment was had during the process of voting.⁶

§ 1251. **Of the Right to demand a Poll.** — The right to demand a poll exists at common law, even where each elector has but one vote.⁷ Where the modern system of voting

¹ *McMillan v. LeRoi Mining Co.* (1906), 1 Ch. 331.

² *McMillan v. LeRoi Mining Co.* (1906), 1 Ch. 331.

³ *Horbury Bridge Co.*, 11 Ch. D. 109, 114.

⁴ *Chillington Iron Co.*, 29 Ch. D. 159.

But see *British Flax, etc. Co.*, 60 L. T. 215.

⁵ As to the unexpectedly early closing of a poll, see *Chenango Co.*, 19 Wend. (N. Y.) 635, 637.

⁶ *Penobscot, etc. R. R. Co. v. Dunn*, 39 Me. 587, 600 (headnote inadequate).

⁷ *Campbell v. Maund*, 5 A. & E. 865.

by shares is applicable, the reasons for allowing a poll are far stronger, so that the shareholders' right to insist upon the same should be extended rather than restricted. In England, however, the courts have inclined the other way, and have limited in many respects the right to a poll. Perhaps one explanation of this tendency may be found in the great delays that are caused by the English practice of taking a poll with such deliberation that, if it were demanded frequently, shareholders would never be able to reach any conclusions. At all events, the poll may be demanded after the announcement of the result of the preliminary vote by show of hands;¹ indeed, not till then can a shareholder intelligently decide whether or not a poll is desirable. Where, immediately before the meeting, the requisite number of shareholders communicate to the chairman their desire that a poll be taken, that is a sufficient demand.² In England it is held that a proxy, even when voting by proxy is authorized, cannot demand a poll, but this decision seems narrow and would hardly be followed in the United States.³ It is also held in England that where a poll is taken without a proper demand, the result of the poll will not prevail over the result of the preliminary vote by show of hands;⁴ but this decision, one may safely say, will not be followed in the United States, where polls are customarily taken without any formal demand at all. Indeed, in view of the obvious intent that a majority in interest shall control the company, the English decision is much to be regretted. In the United States it is held, and with good reason, that wherever plural voting is allowed every voter has a right to insist that the vote on any question be taken by shares, and necessarily, therefore, that a poll be taken.⁵ But with us, as in England, a vote *viva voce* or by show of hands is valid if no poll or vote by shares be demanded.⁶

¹ *Campbell v. Maund*, 5 A. & E. Ky. 405; 33 S. W. 188; *P. B. Matthiason Mfg. Co.* (Mo.), 99 S. W. 865, 880-881.

² *Phoenix Electric Light Co.*, 31 W. R. 398.

³ See *infra*, § 1262.

⁴ *Regina v. Government Stock Investment Co.*, 3 Q. B. D. 442.

But see *Campbell v. Maund*, 5 A. & E. 865, 881.

⁵ *Rochester Dist. Tel. Co.*, 40 Hun (N. Y.) 172.

Cf. *Procter Coal Co. v. Finley*, 98

⁶ *Jones v. Concord, etc. R. R. Co.*, 67 N. H. 119, 145 (headnote inedquate); 38 Atl. 120; *Walker v. Johnson*, 17 App. D. C. 144, 160-161; *Schmidt v. Pritchard* (Iowa), 112 N. W. 801 (where after a motion to adjourn had been pronounced by the chairman carried upon a vote by ayes and noes, the opposing faction,

§ 1252-§ 1272. PROXIES.

§ 1252. **When Voting by Proxy is allowable.** — At common law each member of a corporation could vote in person only, and could not give a proxy or power of attorney for that purpose.¹ Nowadays we have become so accustomed to a different practice that we often fail to recognize how logical and indeed necessary was this rule of the common law. For one should recollect that in no other case is an elector permitted to vote by proxy.² For example, the members of a municipal corporation at a municipal election can of course vote only in person. So, directors of a business company cannot vote by proxy.³ And, accordingly, it was a necessary deduction that the members of an ordinary business corporation must cast their votes in person. As already hinted, this rule is nowadays usually abrogated by statute, so as to authorize voting by proxy; and even where no statutory change has been made in the common-law rule, any company may by its regulations or by-laws authorize voting by proxy.⁴

§ 1253. *Proxy from one Co-owner to another at Common Law.* — It is sometimes said that there is one case in which a proxy is good at common law — namely, the case of joint owners of shares, such as co-administrators, who may give a proxy to any one of

instead of demanding in legal form a poll or vote by shares, proceeded to ignore the vote to adjourn and attempted to continue the meeting).

But see *P. B. Mathiason Mfg. Co.* (Mo.), 99 S. W. 502.

¹ *Harben v. Phillips*, 23 Ch. D. 14, 22, 32, 35; *Scanlan v. Snow*, 2 App. D. C. 137 (semble); *Taylor v. Griswold*, 2 Green (N. J.) 222; 27 Am. Dec. 33; *People v. Twaddell*, 18 Hun (N. Y.) 427; *Brown v. Commonwealth*, 3 Grant Cas. (Pa.) 209 (semble); *Commonwealth v. Bringhurst*, 103 Pa. St. 134; 49 Am. Rep. 119; *Perry v. Tuskaloosa, etc. Co.*, 93 Ala. 364; 9 So. 217; *McKee v. Home Savings & Trust Co.*, 98 N. W. 609; 122 Iowa 731 (semble).

Cf. *State v. Tudor*, 5 Day (Conn.) 329; 5 Am. Dec. 162.

² "The right of voting by proxy is not a general right The only case in which it is allowable, at the common law, is by the peers of England, and that is said to be by virtue of a special permission of the King." *Phillips v. Wickham*, 1 Paige (N. Y.) 590, 598.

³ *Infra*, § 1458.

⁴ *People v. Crossley*, 69 Ill. 195; *State v. Tudor*, 5 Day (Conn.) 329; 5 Am. Dec. 162; *Commonwealth v. Detwiler*, 131 Pa. St. 614; 18 Atl. 990; 7 L. R. A. 357; *Market Street Ry. Co. v. Hellman*, 109 Cal. 571; 42 Pac. 225; *McKee v. Home Savings & Trust Co.*, 98 N. W. 609; 122 Iowa 731; *Walker v. Johnson*, 17 App. D. C. 144.

Contra, *Taylor v. Griswold*, 2 Green (N. J.) 222; 27 Am. Dec. 33.

their number.¹ But this is hardly a proxy at all, since where there are several co-owners the law recognizes any one of them as competent to vote in respect of the common property.²

§ 1254. **By-laws restricting Statutory Right of Voting by Proxy.** — Where the right to vote by proxy is given by statute, a by-law requiring proxies to be members of the company has been held to be void.³ So too, where an unrestricted right of voting by proxy is given by statute, it is held that a by-law cannot require that proxies shall specifically state on their face the meeting at which they are to be used.⁴ These decisions, however, seem very narrow.

§ 1255-§ 1256. *Form of Proxies.*

§ 1255. **In general.** — In the absence of any express provisions as to the form of proxies, no particular form is requisite.⁵ Upon grounds of convenience it would seem that every proxy ought to be in writing,⁶ but it need not be attested or acknowledged⁷ or sealed⁸ or dated.⁹ Nor need it specify the meeting at which it is to be used.¹⁰ Moreover, it need not mention the deputy by name, but may use any reasonable description, and for example may authorize any member for the time being of a specified firm to act as proxy.¹¹ Indeed, an agreement by several shareholders that their shares should be voted in a block, the vote of the entire lot being determined by ballot, is so

¹ *Scanlan v. Snow*, 2 App. D. C. 137.

² See *supra*, § 1228.

³ *Lighthall Mfg. Co.*, 47 Hun (N. Y.) 258; *People's Bank v. Superior Court*, 104 Cal. 649; 38 Pac. 452; 43 Am. St. Rep. 147; 29 L. R. A. 844 (where the statute expressly provided that a by-law might regulate the mode of voting by proxy).

⁴ *White v. New York, etc. Soc.*, 45 Hun (N. Y.) 580.

⁵ As to proxies in blank, see *White v. New York, etc. Soc.*, 45 Hun (N. Y.) 580; *Sadgrove v. Bryden* (1907), 1 Ch. 318.

⁶ *St. Lawrence Steamboat Co.*, 44 N. J. Law 529, 534.

But see *Hoene v. Pollak*, 118 Ala. 617; 24 So. 349; 72 Am. St. Rep. 189.

⁷ *St. Lawrence Steamboat Co.*, 44 N. J. Law 529 (headnote inadequate).

⁸ *Hankins v. Newell* (N. J.), 66 Atl. 929.

⁹ *St. Lawrence Steamboat Co.*, 44 N. J. Law 529 (headnote inadequate).

¹⁰ *White v. New York, etc. Soc.*, 45 Hun 580.

¹¹ *Bombay-Burmah Trading Corp. v. Dorabji Cursetji* (1905), A. C. 213.

far a proxy as to authorize the majority of the parties to the agreement to vote the shares of the minority.¹

§ 1256. **Under Regulations prescribing Formalities.** — Provisions in statutes or by-laws authorizing the use of proxies are enabling provisions and must be closely followed. No formalities can safely be omitted, for every provision as to the form of the proxies will be construed as mandatory and not merely directory.² Thus, where the company's regulations provide that proxies shall be in writing and attested, an unattested proxy is void.³ Of course, it is not necessary that a form of proxy given in the company's articles should be followed literally; substantial and reasonable compliance is sufficient. Thus, where the form prescribed in the articles begins, "I, one of the members, etc.," a proxy describing the appointor as a "proprietor of shares" instead of a member is nevertheless valid.⁴ So, a misnomer of the corporation in the proxy will not destroy its validity if the company is designated with sufficient accuracy for purposes of identification.⁵

§ 1257. **Proxies from Corporations.** — Of course where voting by proxy is allowed, a corporation which is the holder of shares may give a proxy;⁶ indeed, it is difficult to see how a corporation can vote otherwise than by proxy, although if proxies were not permitted doubtless a vote cast by one of the corporation's chief officers would be deemed a vote by the corporation in person. A proxy issued by the board of directors will be good.⁷

§ 1258. **Who may act as Proxy.** — Ordinarily, where voting

¹ *Smith v. San Francisco, etc. Ry.* "duly filed" to be directory Co., 115 Cal. 584; 47 Pac. 582; 56 merely.

Am. St. Rep. 119; 35 L. R. A. 309. ² *Harben v. Phillips*, 23 Ch. D. 14.

In connection with this case the peculiar California doctrines as to the right to vote in respect of shares should be borne in mind. Supra, ⁴ *Indian Zoedone Co.*, 26 Ch. D. 70, 78.

⁵ *Langan v. Francklyn*, 29 Abb. N. C. 102; 20 N. Y. Supp. 404.

² But see *Farwell v. Houghton Copper Works*, 8 Fed. 66, 68 ⁶ *Indian Zoedone Co.*, 26 Ch. D. 70, 78.

(headnote inadequate), holding a ⁷ *State v. Rohlfss* (N. J.), 19 Atl. provision that proxies shall be Rep. 1099.

by proxy is allowed, any person may act as proxy if duly deputized by the principal. Thus, where no transfer of shares is effective unless approved by the directors, a shareholder may execute a proxy to a person to whom he has assigned the shares even if the transfer has never been presented to the directors for their approval;¹ the shareholder's freedom of choice in the selection of his proxy cannot be controlled by any supposed evasion of the law against transferring shares without the directors' consent. So, as already stated, where a statute allows voting by proxy, it has been held that a by-law providing that only shareholders may act as proxies is void, even though the statute also provide that the company may regulate voting by proxy.² A regulation requiring all proxies to be shareholders is satisfied if the proxy is a shareholder when the authority is to be exercised, although he was not a shareholder when the appointment was made.³

§ 1259. **Proxy to two or more Persons jointly.** — A proxy which is issued to two or more persons jointly and not in the alternative cannot be exercised unless they agree as to how the votes should be cast.⁴

§ 1260. **Genuineness of Proxies — How determined.** — Where the genuineness of a proxy is challenged at the meeting, a difficult question will be raised; and the chairman's decision thereon will not be overruled by the courts without clear proof.⁵ But a rejection of proxies by the chairman will be wrongful if there were no reasonable grounds for suspicion, and the presence of blanks for the date does not constitute such reasonable ground.⁶ It is upon this principle that the decision in *Re Cecil*⁷ should be rested. There, an inspector refused to receive proxies unless they were supported by an affidavit as to their genuineness. The court very properly held that this was erroneous, but in doing so declared that an inspector has no right to reject a proxy if it is fair on its face. But surely this dictum cannot be law.

¹ *Stephenson v. Vokes*, 27 Ont. (Can.) 691 (headnote inadequate).

² *Supra*, § 1254.

³ *Bombay-Burmah Trading Corp. v. Dorabji Cursetji Shroff* (1905), A. C. 213.

⁴ *Sullivan v. Parkes*, 69 N. Y. App. Div. 221; 74 N. Y. Supp. 787. 477.

⁵ *Indian Zoedone Co.*, 26 Ch. D. 70. Cf. *Mousseaux v. Urquhart*, 19 La. Ann. 482, 485; *People v. Crossly*, 69 Ill. 195.

⁶ *St. Lawrence Steamboat Co.*, 44 N. J. Law 529.

⁷ *Re Cecil*, 36 How. Pr. (N. Y.)

An inspector cannot reject a proxy without just ground for suspicion, but if forgery be proved to his satisfaction, what can he do but refuse to receive the vote? If his decision is erroneous, it can be corrected by the courts. It would seem that a proxy cannot be relied upon to establish the legality of a vote unless the proxy paper was presented at the meeting.¹

§ 1261. **Ratification of Vote by unauthorized Proxy.** — Where a vote is cast ostensibly as proxy by a person not duly authorized to act as such, it is submitted that no ratification after the meeting should be held to validate the transaction; for the other shareholders have a right that all votes shall be legal when cast. But the California Supreme Court has held that ratification even after the meeting is equivalent to prior authorization.² Of course, a shareholder whose stock has been voted on by an unauthorized proxy may by his subsequent conduct estop himself from raising any objection; but if the vote can be *ratified*, in the proper sense of the word, it becomes valid not merely as to himself but as to his fellow shareholders; and this, it is submitted, would be unjust.

§ 1262. **Effect of Proxies — Powers of Proxy.** — In England it has been held that on a vote by show of hands a shareholder has but one vote although he holds proxies for several other shareholders;³ and this seems reasonable, since a show of hands is merely a crude, expeditious way of taking the sense of the meeting; and its quickness, its chief recommendation, would be lost if the chairman were obliged to stop to ascertain for how many persons each voter holds proxies. The English Court of Appeal admitted that a non-member holding a proxy for one or more shareholders would be entitled to one vote on a show of hands.⁴

It has also been held in England that where by the regulations a poll is demandable by shareholders holding in the aggregate a

¹ Cf. *Schmidt v. Mitchell*, 101 Ky. Ass'n, 117 Fed. 379; 54 C. C. A. 570, 582; 41 S. W. 929; 72 Am. St. 553.
Rep. 427.

² *Market Street Ry. Co. v. Hellman*, 109 Cal. 571; 42 Pac. 52 L. T. 846.
225.

Cf. *Hoene v. Pollak*, 118 Ala. 617; 1 Ch. 603.

24 So. 349; 72 Am. St. Rep. 189; ³ *Ernest v. Loma Gold Mines*
Synnott v. Cumberland Bldg. Loan (1897), 1 Ch. 1, 8.

certain number of shares, proxies held by the persons demanding a poll cannot be counted in order to make up that required number.¹ But this seems a very narrow construction. A proxy is a power of attorney; and whenever proxies are lawful the principal is deemed present and acting by his agent. *Qui facit per alium facit per se*. In legal contemplation, not the proxy but his principal is demanding the poll. Hence, it is submitted that the proxy should have every right and power that his principal if present would have. The case of a vote by show of hands is exceptional and peculiar, as explained above, because of the very nature and object of voting in that tentative, loose, and hasty way.

Accordingly, it is held in America that a proxy may generally do all that the principal might have done if present, and hence may vote not merely on the main question, but also on all subsidiary and incidental motions, such, for instance, as a motion to adjourn;² although of course a proxy may be framed in such restricted terms as to confine the agent's right to vote to some one matter, such as the election of directors.³ Moreover, it has been held that proxies framed in general terms apply only to the ordinary business of the company, and hence are not available on a motion that the company dissolve.⁴ Proxies may be counted in determining whether a quorum is present at a meeting.⁵ The contention has been made that a proxy is authorized to act only at lawful meetings, and that therefore the fact of his voting at an irregularly convened meeting does not estop his principal from questioning its validity; but the courts have taken a different view, holding that any irregularity that might have been waived by the shareholder if personally present may be waived by his proxy.⁶ But the proxy can bind the principal

¹ *Regina v. Government Stock Investment Co.*, 3 Q. B. D. 442. *ford Electric Co.*, 57 N. J. Eq. 42; 41 Atl. 488 (affirmed, 58 N. J. Eq. 584; 43 Atl. 1098).

² *Forsyth v. Brown*, 33 Wkly. Notes Cas. (Pa.) 72.

³ *Cumberland Coal Co. v. Sherman*, 30 Barb. 553, 557 (headnote inadequate). ⁶ *Columbia Nat. Bank v. Matthews*, 85 Fed. 934; 29 C. C. A. 491; *Jones v. Milton, etc. Turnpike Co.*, 7 Ind. 547.

⁴ *McKee v. Home Savings & Trust Co.*, 98 N. W. 609; 122 Iowa 731. Cf. *Franco-Texan Land Co. v. Laigle*, 59 Tex. 339, 345 (headnote inadequate — the court holding that proxy cannot represent principal at

⁵ *Franklin Trust Co. v. Ruther-*

only in the latter's capacity of shareholder, and has no implied authority to waive for him his rights as creditor or bondholder.¹

Moreover, if a proxy exceeds his authority, it has been held that the principal will be taken to have ratified the action unless a prompt repudiation is pronounced;² but this conclusion involves a decision that unauthorized proxies may be ratified after the meeting at which they are used — a decision which has been criticised above.³

Manifestly a proxy can vote only when his principal might do so in person; and hence, when a statute confines the right to vote to citizens, an alien shareholder cannot vote by giving a proxy to a citizen.⁴

§ 1263. *Action of Proxy where his Interests conflict with those of his Principal.* — A proxy must, of course, honestly and fairly endeavor to subserve the interests of his principal, and like other agents must not place himself in a position where his individual interests conflict with his duty to his principal. If he do so, without his principal's consent, it would seem that the latter may repudiate his action unless the rights of third persons would be prejudiced by such repudiation.⁵

§ 1264—§ 1267. *Revocation or Expiration of Proxies.*

§ 1264. **In general.** — Proxies, being mere powers of attorney, are ordinarily revocable at will by the principal. This is true although the period during which by their terms they are to remain operative has not expired or although the mode of revocation prescribed in the instrument itself is not followed.⁶ So, a proxy is revoked by the principal's death, or it seems by his presence in person at the meeting.⁷ But a proxy given by a foreign shareholder is not terminated by the breaking out

meeting held in a foreign state);
P. B. Mathiason Mfg. Co. (Mo.), 99
S. W. 502.

¹ *Moore v. Ensley*, 112 Ala. 228;
 20 So. 744.

² *Synnott v. Cumberland Bldg.*
Loan Ass'n, 117 Fed. 379; 54
C. C. A. 553.

³ *Supra*, § 1261.

⁴ *Re Barker*, 6 Wend. (N. Y.)
 509.

⁵ See *United Gold, etc. Co. v.*
Smith, 44 N. Y. Misc. 567; 90 N. Y.
 Supp. 199.

⁶ *Schmidt v. Mitchell*, 101 Ky.
 570; 41 S. W. 929; 72 Am. St. Rep.

⁷ *Schmidt v. Mitchell*, 101 Ky.
 570; 41 S. W. 929; 72 Am. St. Rep.
 427.

of war between his country and the domestic sovereign.¹ Of course a proxy may be so framed as to expire without any affirmative revocation after the lapse of a given time or the occurrence of some given event. In the absence of any such provision a proxy continues in force indefinitely until revoked, although possibly long lapse of time during which no use was made of the proxy might be deemed evidence of an intention to revoke.² Sometimes statutes provide that no proxy shall be valid unless executed within some specified period prior to the meeting at which it is to be used.

§ 1265. **Proxies expressed to be irrevocable** — *Voluntary Proxies*. — What if an intention appear on the part of the principal to make the proxy irrevocable? Will the law effectuate this intent? Where no consideration is received for executing the proxy, clearly this question should be answered in the negative.³

§ 1266. *Proxies supported by valuable Consideration*. — But where the principal agrees for a valuable consideration that the proxy shall be irrevocable, the matter is more difficult. Several legal objections may be urged against carrying out this intention of the parties that the proxy shall not be revocable.

(a) *Objection that Proxies as Powers of Attorney are by their very Nature necessarily revocable*. — In the first place, it may be said that all powers of attorney are by their very nature revocable,⁴ and that no man can give an irrevocable power over his own property, unless the power be "coupled with an interest" — that is, unless the donee of the power have some interest in the property, over which the power is to operate. This proposition in the law of agency and property, even if true, does not depend on any peculiar nature of a power of attorney to vote in the principal's stead at corporate meetings, and therefore need receive little consideration in a treatise on corporation law.

¹ *Mousseaux v. Urquhart*, 19 La. 570; 41 S. W. 929; 72 Am. St. Rep. Ann. 482.

² Cf. *Mousseaux v. Urquhart*, 19 La. Ann. 482.

³ *Woodruff v. Dubuque, etc. R. Co.*, 30 Fed. 91; *Schmidt v. Mitchell*, 101 Ky. 570; 41 S. W. 929; 72 Am. St. Rep. 427.

⁴ See *Schmidt v. Mitchell*, 101 Ky.

In *Reed v. Bank of Newburgh*, 6 Paige (N. Y.) 337, it was declared that a proxy given for a valuable consideration may always be revoked when about to be used for a fraudulent purpose.

But, more probably than not, the proposition in all its generality does not embody sound law. To be sure, no irrevocable power of this sort can bind a purchaser for value without notice of the restriction on the ownership of the shares; but one may well doubt whether the ordinary principles of the law of agency and property prevent a property owner from giving for a consideration a power of attorney to exercise certain of the rights of ownership which, as against the donor of the power and all persons with notice claiming under him, shall be irrevocable.¹

(b) *Objection that Public Policy forbids irrevocable Separation of Beneficial Ownership of Shares from Right to Vote thereon.* — A second objection that may be raised is that the policy of the law of corporations forbids an irrevocable separation between the beneficial ownership of shares and the right to vote in respect thereof. Sometimes this objection is made insuperable by statute.² And, clearly, public policy does prevent a shareholder from severing from his beneficial ownership the incidental right of voting, to the prejudice of a purchaser of the shares who is without notice of the proxy. But as against the original giver of the proxy and all parties with notice, why should the law forbid the shareholder from parting irrevocably with one of the incidents of his ownership? Is it not lawful for him to do what he will with his own? As we have seen, an ordinary trustee is clothed with the power of voting in respect of the shares which belong to the trust estate, and yet, although the beneficial interest is in the *cestui que trust*, no policy of law is deemed to be violated.

(c) *Objection that Public Policy forbids a Shareholder from parting with Right to Vote for a valuable Consideration — from selling his Vote.* — The third objection, which is closely akin to the second, is that public policy forbids a shareholder from selling his vote or from parting with his right to vote for a valuable consideration. This objection has already been considered in connection with the subject of agreements to refrain from voting

¹ *Hey v. Dolphin*, 92 Hun (N. Y.) etc. Co., 5 Blatchf. 525, where, however, the legal title to the shares stood in the name of the so-called proxies.

etc. R. R. Co. v. Nicholas, 98 Ala. 92; ² Cf. *Shepaug Voting Trust Cases*, 12 So. 723. 60 Conn. 553; 24 Atl. 32.

See also *Brown v. Pacific Mail*,

or to vote in a particular way.¹ It may or may not be fatal to the validity of a proxy which has been given for a valuable consideration and which is intended to be irrevocable. Whether the objection is sound or not depends on the particular facts of each case.

(d) *Objection that the Company is not bound to take Cognizance of the Agreement even if valid inter partes.* — Fourthly, even if it be conceded that an agreement by a shareholder to vote in a particular manner or to permit another to vote in his name is not necessarily illegal or void *inter partes*, yet reasons of convenience may be urged why the corporation should not be bound to take cognizance of such an agreement. For how is the company to determine in the hurry of a corporate meeting whether such agreements are supported by good and legal considerations? *Prima facie*, all proxies are revocable, and *prima facie* the legal owner of shares is always entitled to vote for such resolutions as, at the time of the meeting, may please him. An agreement by a shareholder restricting this right to vote, or purporting to make a proxy irrevocable, may be valid *inter partes*, but should not affect the company.² The object of a list of shareholders is to enable the corporation to determine who are entitled to vote at its meetings; and the corporation should always receive the vote of the registered shareholder or of the person claiming as proxy under the power of attorney of latest date. The parties aggrieved by this breach of contract of the registered shareholder may reasonably seek preventive relief by way of injunction, or may have an action at law for damages; but the vote is valid.

But although these views are believed to be sound, they have not met with universal acceptance. Thus, an agreement by three persons, who are about to purchase stock in a company, to pool their shares and vote the whole as a majority of them may direct, has been held in California to be binding — and on this point it is submitted that the decision is clearly sound — and also to amount to an irrevocable proxy of which the cor-

¹ See *supra*, § 1238.

² “Any private agreement, or understanding between the person holding the legal title in due form, and others, is a matter between themselves with which the corpora-

tion have no concern.” *Long Island R. R. Co.*, 19 Wend. (N. Y.) 37, 44; 32 Am. Dec. 429; per Nelson, C. J. Cf. *Sylvania, etc. R. Co. v. Hoge* (Ga.), 59 S. E. 806.

poration is bound to take notice.¹ This conclusion may be explained because of the peculiar doctrine that prevails in California with reference to the persons entitled to vote on shares of stock.² Where the agreement is not merely between individual shareholders, but is contained in a general scheme of reorganization or the like, to which the company itself is a party, the case may be treated much as if the shares which are subject to the arrangement had been transferred on the company's books to the persons who are to have the power of voting on them. Cases where such transfers are made are discussed below.³

§ 1267. **Effect of Irrevocable Proxy — Disagreement of Deputies.** — Even if an agreement that a proxy shall be irrevocable be binding, nevertheless it should not be construed to prevent the principal from voting in person whenever those named as proxies or deputies are unable to agree among themselves how the votes should be cast, so that unless the principal were allowed to vote in person his shares would have no voice in the management of the company.⁴

§ 1268-§ 1272. VOTING TRUSTS.

§ 1268. **Nature of Voting Trust.** — The so-called "voting trusts" are sometimes treated as attempts to confer irrevocable proxies;⁵ but this notion overlooks the real nature of such "trusts."⁶ In the ordinary case of a voting trust, shares are

¹ *Smith v. San Francisco, etc. Ry. Co.*, 115 Cal. 584; 47 Pac. 582; 35 L. R. A. 309; 56 Am. St. Rep. 119.

² *Supra*, § 1220.

³ *Infra*, § 1268 et seq.

⁴ *Sullivan v. Parkes*, 69 N. Y. App. Div. 221; 74 N. Y. Supp. 787.

⁵ *Brown v. Pacific Mail, etc. Co.*, 5 Blatchf. 525.

⁶ *Cf. Glen Salt Co.*, 17 N. Y. App. Div. 234; 45 N. Y. Supp. 568; *Shepaug Voting Trust Cases*, 60 Conn. 553, 578, 580; 24 Atl. 32.

⁶ *Cf. Haines v. Kinderhook, etc. Ry. Co.*, 33 N. Y. App. Div. 154 (headnote inadequate); 53 N. Y. Supp. 368.

In some cases in which the dis-

inction between a trust and a proxy has been recognized, the courts have nevertheless declared that both should be governed by like rules. Thus, in *Kreissl v. Distilling Co.*, 61 N. J. Eq. 5, 14; 47 Atl. 471, Magie, C., said: "When the scheme devised does not embrace a grant of irrevocable powers by proxy, but seeks a similar object by the creation of a trust and the appointment of a trustee, a like doctrine must be applied."

An agreement which is invalid as a voting trust may be valid as a proxy so long as it is unrevoked. *Lord v. Equitable Life Ass. Soc.*, 108 N. Y. Supp. 67.

transferred on the company's books to trustees, to whom share-certificates are issued by the corporation and who become clothed with the legal title. These trustees execute to the transferors of the shares "certificates of beneficial interest" which are in legal effect declarations of trust. The holders of these certificates, or *cestuis que trust*, are entitled to all the rights of beneficial ownership, except that the trustees are vested with the power of voting the shares at corporate meetings uncontrolled by the wishes of the beneficiaries.

§ 1269-§ 1270. *Whether Voting Trust is legal.*

§ 1269. **On Principle.** — What possible objection can be sustained to such arrangements? It is said that public policy forbids a separation of the beneficial ownership from the right to vote, but we have seen that the law itself makes this separation in every case of a trust of shares of stock. It is true that in cases of dry trust, the trustee must exercise the power of voting at the dictation of the *cestui que trust*, so that there is, it may be said, no real and substantial severance between the voting power and the beneficial ownership. But in the case of an active trust, or where the *cestui que trust* is a minor or other person under a disability, the trustee may vote according to his own discretion,¹ and the separation between the beneficial interest and the voting power is complete. Why then should there be any objection to the ordinary voting trust? A "voting trustee" is a bare trustee except as to the power of voting, as to which he is an active trustee; and no objection can be urged against the validity of a "voting trust" that would not apply with equal force to an active trust, where the trustee's discretion in voting the shares is controlled only by his own sense of right and by his accountability to a court of equity for his administration of the trust.

It may be argued that where shares are held in trust for a person *sui juris*, and where the entire beneficial interest is vested in him, he may at any time terminate the trust and supersede the trustee's right to vote. The answer to this argument as applied to the ordinary voting trust is that each share-

¹ Cf. *Toler v. East Tennessee, etc. Miller*, 47 Atl. 345, 347; 60 N. J. Eq. Ry. Co., 67 Fed. 168, 180; *Clowes v.* 179.

holder is not invested with the entire beneficial interest in the shares held in trust for him, but that every shareholder who assented to the voting trust has to the extent of the voting rights an interest in the shares of every other assenting shareholder. It is doubtless true that if all the shareholders who assented to the voting trust should unite in asking that it be terminated, the voting trustees would have no right to insist on the continuance of the trust.

If a voting trust were intended to endure forever, it might infringe the rule against perpetuities; but in the ordinary case a voting trust is limited in duration to some short period of years, so that no such objection can apply.¹ If, moreover, the trustees are to act at the dictation of persons not members of the company who are to stand in no fiduciary relation to the shareholders whose shares are put into the trust, the arrangement is open to more serious objections, as the differences from an ordinary trust are then much greater.² And it may be conceded that an agreement between a trustee and his *cestui que trust* that the former might vote, in respect of the shares held in trust, as his own individual interests might dictate, would be obnoxious to the policy of the law.³ It is one thing to give a trustee a discretion to vote as he may think best for his beneficiaries, and quite a different thing to give him the power to vote as he chooses, irrespective of what he may think his *cestuis que trust's* interests require.

§ 1270. **The Decisions.** — Some authorities unquestionably tend to hold that all voting trusts are illegal and void;⁴ but

¹ The terms of the trust in *Warren v. Pim*, 59 Atl. 773, 774; 66 N. J. Eq. 353, seem to have been carefully framed to obviate this objection, as the trust was to cease "when the last survivor of the now existing descendants of Her Majesty shall have been dead for twenty years."

² *Clowes v. Miller*, 47 Atl. 345; 60 N. J. Eq. 179.

See *Mobile, etc. R. R. Co. v. Nicholas*, 98 Ala. 92; 12 So. 723. See *infra*, p. 1054, n. 1.

³ *Railway Co. v. State*, 49 Ohio

St. 668, 680; 32 N. E. 933 (semble).

Cf. *Warren v. Pim*, 59 Atl. 773; 66 N. J. Eq. 353.

⁴ *Harvey v. Linville Improvement Co.*, 118 N. Car. 693; 24 S. E. 489; 54 Am. St. Rep. 749; *White v. Thomas Tire Co.*, 52 N. J. Eq. 178; 28 Atl. 75 (holding that the *cestuis que trust* may compel the voting trustee to vote according to their instructions); *Kreissl v. Distilling Co.*, 61 N. J. Eq. 5; 47 Atl. 471 (with which, however, compare *Chapman v. Bates*, 61 N. J. Eq. 658); *Shepaug Voting*

others, supported it is submitted by sounder reasoning, hold that they are lawful if their object is lawful.¹ A voting trust properly so called may be illegal as an evasion of a statute which makes void all proxies more than a year old.² Of course, if the object of a voting trust is the accomplishment of some illegal end — the restraint of trade, the formation of a monopoly, or the practical merger of two or more corporations in defiance of law, — the courts will have no difficulty in holding the trust illegal. So where the sale by a shareholder of his vote, or the issue of a proxy for money or anything of value is deemed illegal, a transfer of shares for valuable consideration which is absolute on its face, but which is really designed merely to confer on the transferees the power to vote on the stock for a period of three years, is also illegal, and the transferee acquires no right to vote.³ But although stock is put in trust for an illegal purpose, the intended *cestui que trust* is not precluded from compelling the intended trustee to re-transfer the shares.⁴ Where the object of the trust is legitimate, — for instance, to secure control of the company to its bondholders in order to prevent foreclosure and

Trust Cases, 60 Conn. 553; 24 Atl. 32 (where the voting trustee was enjoined from voting). In the case last cited the arrangement was tinged with illegality. 60 Conn. 581.

In some of the above cases a shareholder's right to "separate the voting power from the beneficial interest" for some one particular object was fully recognized, but the right to confer on a trustee the general discretionary power of voting as he may think best was denied. See particularly, *Kreissl v. Distilling Co.*, 61 N. J. Eq. 5; 47 Atl. 471.

Cf. *Warren v. Pim*, 59 Atl. 773; 66 N. J. Eq. 353 (where a bare majority held the trust in question void but were not agreed among themselves as to the reasons for that decision).

¹ *Brown v. Pacific Mail, etc. Co.*, 5 Blatchf. 525; *Mobile, etc. R. R. Co. v. Nicholas*, 98 Ala. 92; 12 So. 723 (as to which case see *infra*, p. 1054, n. 1); *Haines v. Kinderhook, etc. Ry. Co.*, 33 N. Y. App. Div. 154

(headnote inadequate); 53 N. Y. Supp. 368.

Cf. *Hey v. Dolphin*, 92 Hun (N. Y.) 230; 36 N. Y. Supp. 627 (a case of an agreement between two co-owners of shares that for a period of years the right of voting should be vested in one of them).

See also *Shelmerdine v. Welsh*, 20 Phila. 199.

In some of the cases cited in the preceding note the validity of voting trusts for a proper object was admitted, but the courts classed as illegal almost the only objects for which voting trusts are resorted to. See *Kreissl v. Distilling Co.*, 61 N. J. Eq. 5; 47 Atl. 471 (with which compare, however, *Chapman v. Bates*, 61 N. J. Eq. 658; 47 Atl. 638; 88 Am. St. Rep. 459).

² *Shepaug Voting Trust Cases*, 60 Conn. 553; 24 Atl. 32.

³ *Glen Salt Co.*, 17 N. Y. App. Div. 234; 45 N. Y. Supp. 568.

⁴ *Scott v. Scott*, 68 N. H. 7; 38 Atl. 567.

the utter ruin of all the shareholders,¹ — the trust should be upheld and carried out. Some authorities declare that the trust is not effective if supported by no other consideration than the mutual agreement between the shareholders to put their stock into the trust; but no reason is perceived for this conclusion. If the trust is valid, and the trustees have a discretion to determine when the condition of the company is such as to justify the termination of the trust, their discretion in that respect will not be overruled or controlled by the courts in the absence of clear proof that it has been abused.² The powers of the voting trustees do not cease upon a sale of all their individual interests in the company.³

§ 1271. **Power of a "Holding Company" to subject Shares held by it to a Voting Trust.** — Where shares are owned by an investment company, or "holding company," it has been thought the holding company has no power to put the shares in a voting trust, because by so doing it would practically delegate its own corporate powers to voting trustees, leaving its own directors without functions to perform.⁴

§ 1272. **Directions in Will as to Voting upon Shares bequeathed in Trust.** — No legal obstacle would prevent a testator owning shares of stock from putting them in trust in such a way as to vest the voting power in the mere discretion of his trustees (subject of course to the control of a court of equity) throughout the continuance of the trust. Sometimes testators have undertaken to provide that several co-trustees or co-executors shall execute a proxy to one of their number. On principle, there would seem to be no reason to doubt that such a provision is enforceable in chancery;⁵ but on the other hand it clearly does

¹ *Mobile, etc., R. R. Co. v. Nicholas*, 98 Ala. 92; 12 So. 723. This is an extreme case, as the legal title to the shares was not transferred, apparently, to the trustees, and as the voting power was not to be exercised according to the discretion of the trustees themselves, who could be held to account for its misuse, but at the dictation of a majority of a large and constantly changing body of bondholders who could with difficulty be held to any account for an abuse of their power.

² *Haines v. Kinderhook, etc. Ry. Co.*, 33 N. Y. App. Div. 154; 53 N. Y. Supp. 368.

³ *Haines v. Kinderhook, etc. Ry. Co.*, 33 N. Y. App. Div. 154; 53 N. Y. Supp. 368.

⁴ *Knickerbocker Investment Co. v. Voorhees*, 100 N. Y. App. Div. 414; 91 N. Y. Supp. 816.

⁵ *Lafferty's Estate*, 154 Pa. St. 430; 26 Atl. 388.

But see query in *Tunis v. Hestonville, etc. R. R. Co.*, 149 Pa. St. 70; 24 Atl. 88; 15 L. R. A. 665.

not *proprio vigore* amount to a proxy, and if no proxy is in fact executed by the co-executors or co-trustees, the one designated by the will as entitled thereto has no right to vote the shares without the concurrence of his fellows.¹

§ 1273-§ 1275. *Presiding Officer at Meetings of Shareholders.*

§ 1273. **Qualifications and Election.**— Important duties and powers in any deliberative assembly are vested in the chairman or presiding officer, and this is as true of shareholders' meetings as of other bodies. No qualifications are prescribed by law for this position. For instance, the chairman need not be a shareholder;² and a mere proxy may call a meeting to order.³ Sometimes the chairman of a meeting is designated by the company's regulations, and if so he is of course the only proper person for the office. Often the duty of presiding at general meetings is vested in the president of the company. But in every meeting there resides an inherent power of choosing its own chairman; and hence if the chairman designated by the regulations is not present, or leaves the room before the meeting has adjourned, the shareholders present may proceed to choose another chairman.⁴ It has been held that where the meeting is to choose its own chairman, the member first calling the meeting to order and making a nomination for the office of chairman is entitled to put his nomination to a vote and to declare the result:⁵ "the first regular and formal proceeding for an organization should have a preference in law."⁶ Where the regulations provide that the president if present shall act as chairman of all meetings, and that in his absence a president *pro tempore* shall be chosen, proceedings of a meeting conducted in violation of this rule, the president although present not acting as chairman and no president *pro tempore* being chosen in his stead, have been held

¹ *Tunis v. Hestonville, etc. R. R. Co.*, 149 Pa. St. 70; 24 Atl. 88; 15 L. R. A. 665.

² *Stebbins v. Merritt*, 10 Cush. (Mass.) 27.

³ *People v. Albany, etc. R. R. Co.*, 55 Barb. 344, 361.

⁴ *National Dwellings Soc. v. Sykes* (1894), 3 Ch. 159. As to the chair-

man's power to appoint a substitute, see *People v. Albany, etc. R. R. Co.*, 55 Barb. 344.

⁵ *Pioneer Paper Co.*, 36 How. Pr. (N. Y.) 105.

See also *Procter Coal Co. v. Finley*, 98 Ky. 405; 33 S. W. 188.

⁶ *Pioneer Paper Co.*, 36 How. Pr. (N. Y.) 105, 107.

to be void,¹ a very strict decision. Where a person has once regularly been chosen as chairman of a meeting, he is entitled to preside at that meeting and all adjournments thereof until superseded in some orderly parliamentary manner.² If the lawful chairman is forcibly prevented from taking the chair, he and his followers may retire to an adjacent place, and there organize the meeting: the actions of such meeting are valid, although those in attendance are not a majority of the corporation.³

§ 1274. **Duties and Powers.** — A chairman's duties are, ordinarily, to preserve order and to endeavor to bring out the real sense of the meeting; and his powers are such only as are incidental to the proper performance of these duties. He has no legislative power. Hence, he has no right to declare the meeting adjourned without a vote of the members,⁴ unless that power is given him by the company's regulations;⁵ and if he undertakes to do so and leaves the room with his followers, the meeting is nevertheless not legally adjourned or terminated, and therefore a resolution which is passed after his withdrawal by the shareholders remaining in the room is valid.⁶ Upon the same principle, when a proper amendment to a pending motion is offered, the chairman's clear duty is to put the amendment to a vote; and if he wrongfully declines to do so and instead takes a vote on the main question, the passage of the unamended resolution is invalid.⁷ The chairman ought to explain any motion that is made and to inform the shareholders of the effect of any vote

¹ *State v. Pettineli*, 10 Nevada 41; *Chicago Macaroni Co. v. Boggi-ano*, 202 Ill. 312; 67 N. E. 17.

But see *Argus Printing Co.*, 1 N. Dak. 434, 449; 48 N. W. 347; 26 Am. St. Rep. 639, as to the acquiescence of the shareholders in suffering one to act as chairman who was not legally entitled to do so.

² *Commonwealth v. Patterson*, 158 Pa. St. 476; 27 Atl. 998.

³ *Field v. Field*, 9 Wend. (N. Y.) 394.

Cf. *Pioneer Paper Co.*, 36 How. Pr. (N. Y.) 105.

⁴ *National Dwellings Soc. v. Sykes* (1894), 3 Ch. 159; *State ex rel. Ryan v. Cronan*, 23 Nevada 437; 49 Pac.

⁵ *Salisbury Gold Mining Co. v. Hathorn* (1897), A. C. 268, where it was held that under the company's regulations a motion to adjourn could not be received without the chairman's assent.

⁶ *National Dwellings Soc. v. Sykes* (1894), 3 Ch. 159; *Rochester District Tel. Co.*, 40 Hun (N. Y.) 172.

Cf. *State ex rel. Ryan v. Cronan*, 23 Nevada 437; 49 Pac. 41.

But see *Haskell v. Read*, 96 N. W. 1007; 93 N. W. 997; 68 Nebr. 107.

⁷ *Henderson v. Bank of Australasia*, 45 Ch. D. 330.

that is to be taken; but if his glosses and explanations turn out to be erroneous, the validity of the action taken is not affected. Thus, where a resolution having been offered for the confirmation of a written contract which had been provisionally entered into by the directors, the chairman gave some explanations of the agreement to be confirmed, after which the resolution was passed; yet the court held that the validity of the confirmatory resolution was not impaired by any misinterpretation of the agreement into which the chairman in his explanations had fallen.¹ Although the declarations of the chairman cannot create any new obligation binding upon the company, yet they have been received as evidence upon the question whether the inaction of preferred shareholders should be characterized as laches or merely as forbearance.²

It would seem clear that unless inspectors, scrutineers, or other officials are appointed, the chairman must have the right to rule on the validity of any votes that may be offered,³ subject perhaps to an appeal to the meeting at large. A dictum in a Minnesota case is to the contrary,⁴ but would probably not be followed.

If the chairman is authorized to appoint a committee, the appointment need not be made during the meeting, but may be made after adjournment.⁵

§ 1275. **Effect of Chairman's Rulings.**—The chairman's rulings and decisions will be accepted by the courts as *prima facie* correct.⁶ For instance, where the chairman pronounces that A and B have been elected directors, they are *prima facie* entitled to the office.⁷ So, where the chairman rules that certain

¹ *Salisbury Gold Mining Co. v. Hathorn* (1897), A. C. 268, 276.

² *Smith v. Cork, etc. Ry. Co.*, 5 Ir. Rep. Eq. 65, 74 (headnote inadequate).

³ *Indian Zoedone Co.*, 26 Ch. D. 70.

⁴ *State v. Chute*, 34 Minn. 135; 24 N. W. 353.

⁵ *Burton v. St. George's Soc.*, 28 Mich. 261.

⁶ Cf. *Hartt v. Harvey*, 32 Barb. 55; *Gipson v. Morris*, 83 S. W. 226; 73 Tex. 85; 36 Tex. Civ. App. 593.

⁷ *Wandsworth, etc. Gas Co. v. Wright*, 18 W. R. 728. *A fortiori*, where proxies are objected to solely on the ground that under the company's constitution proxies were not permissible, the court, having held that objection to be unfounded, will not hold the reception of the proxies to have been illegal because no affirmative evidence was adduced to show the principal to be a member of the corporation. *People v. Crossley*, 69 Ill. 195.

contested proxies are genuine, his ruling stands and will be acted upon by the courts, until it is overthrown by a preponderance of evidence.¹ A mere provision in the company's articles that the chairman's decision that a resolution has been carried shall be sufficient evidence of its passage does not increase the effect of his decision or render it conclusive;² and *a fortiori* his decision is not conclusive in the absence of such a provision.³

But sometimes by statute or a company's regulations a chairman's decision that a resolution has been carried is expressly made conclusive; and in such cases, although his decision may be impeached for fraud, it cannot be overthrown by proof of mere error.⁴ Even, however, where such regulations are in force, the chairman's decision cannot stand if it show upon its face that his conclusion is erroneous in law — for example, that he has counted illegal votes.⁵

It would seem that the chairman's decision, if correct in the result, should stand although he assigned an erroneous reason for it. For instance, votes are properly rejected if for any reason they ought not to have been received, although the particular ground assigned for their rejection was not tenable.⁶ But if the chairman give erroneous reasons for his decision, there is no presumption in favor of its validity,⁷ and the ruling must be justified by affirmative evidence.

§ 1276. **Scrutineers and Inspectors of Election.** — Some of the duties of a chairman are sometimes intrusted to inspectors or scrutineers. There is ample power in the shareholders to

¹ *Indian Zoedone Co.*, 26 Ch. D. 70. Abb. N. C. (N. Y.) 102; 20 N. Y.

² *Horbury Bridge Co.*, 11 Ch. D. Supp. 404 (where substantially the same result seems to have been reached without any express provision).

³ *State v. Smith*, 15 Oreg. 98, 115; 14 Pac. 814; 15 Pac. 137, 386.

⁴ *Hadleigh Castle Gold Mines* (1900), 2 Ch. 419 (overruling *Young v. South African Syndicate* (1896), 2 Ch. 268); *Arnot v. United African Lands* (1901), 1 Ch. 518.

⁵ *Caratal (New) Mines* (1902), 2 Ch. 498. Cf. *infra*, § 1276.

⁶ Cf. *Christopher v. Noxon*, 4 Ont. 672, 682; *Conant v. Millaudon*, 5 La. Ann. 542.

⁷ *Hartt v. Harvey*, 32 Barb. (N. Y.) 55.

Cf. *Wall v. London, etc. Assets Corp.* (1899), 1 Ch. 550; *Harben v. Phillips*, 23 Ch. D. 14, 22–23.

See also *Langan v. Francklyn*, 29

make a by-law vesting in the president the authority to appoint inspectors of election.¹ But where the company's regulations are silent on the subject, the power of choosing inspectors of elections resides in the shareholders themselves and not in the directors or officers.² Where the inspectors chosen by the directors according to the company's regulations refuse to act or are in any way prevented from acting, the shareholders have power in the emergency to designate other inspectors.³ An inspector of election, although having almost judicial duties to perform, may nevertheless be a candidate at the election,⁴ for the shareholders cannot be deprived of their right to vote for whom they please merely because the man of their choice happens to be an inspector. Unless expressly prohibited by statute or the company's regulations, a director or other officer may be an inspector of election.⁵

An election is not invalidated because the inspectors thereof had not been duly chosen or qualified, or had not taken the oath required of them by statute;⁶ if they are inspectors *de facto*, that is enough. But this is not true where the right of the illegally chosen or disqualified inspector is disputed at the time.⁷ *A fortiori* where the directors without authority undertook to appoint inspectors, an election of officers conducted by the inspectors so chosen is not valid as against persons elected at a contemporaneous election conducted by inspectors duly chosen by the shareholders.⁸

The duties of inspectors are simply to pass on the validity of the votes cast, and they have no power to determine whether a candidate for the directorate is qualified for the office.⁹ A by-law purporting to make the rulings of the inspectors or

¹ *Commonwealth v. Woelper*, 3 Serg. & R. (Pa.) 29; 8 Am. Dec. 628.

⁵ *Chenango Co.*, 19 Wend. (N. Y.) 635.

² *State v. Marchant*, 37 Oh. St. 251.

⁶ *Mohawk & Hudson R. R. Co.*, 19 Wend. (N. Y.) 135; *Chenango Co.*, 19 Wend. (N. Y.) 635.

³ *Re Wheeler*, 2 Abb. Pr., n. s. (N. Y.), 361 (headnote inadequate); *People v. Albany, etc. R. R. Co.*, 55 Barb. (N. Y.) 344, 357.

⁷ *Dickson v. McMurray*, 28 Grant Ch. (Up. Can.) 533.

⁴ *Commonwealth v. Woelper*, 3 Serg. & R. (Pa.) 29; 8 Am. Dec. 628; *Ex parte Willcocks*, 7 Cow. (N. Y.) 402, 412; 17 Am. Dec. 525.

⁸ *State v. Marchant*, 37 Oh. St. 251 (headnote inadequate).

Contra: *Dickson v. McMurray*, 28 Grant Ch. (Up. Can.) 533.

⁹ *St. Lawrence Steamboat Co.*, 44 N. J. Law 529, 540 (semble).

judges of election conclusive cannot apply where their decisions are tainted with fraud.¹

§ 1277. **Rejection of Votes not illegal unless they were actually offered.** — In order that the rejection of votes by the chairman or by scrutineers may be held illegal the votes must, generally, be actually offered and disallowed. For instance, where the chairman of the meeting notifies a properly qualified voter that his vote will not be received, whereupon the latter forthwith withdraws from the meeting before any vote is taken, the intention to refuse his vote will not invalidate the action of the meeting;² and the same thing is true where the shareholder instead of withdrawing remains but omits formally to offer his vote.³

§ 1278. **Right of Debate at Shareholders' Meetings.** — The general meeting of a corporation is a deliberative body; and hence reasonable debate must be allowed, and the minority cannot be cut short until after a reasonable opportunity for presenting their views.⁴ But this privilege must not be abused; and therefore after the discussion has lasted a reasonable time the chairman, with the approval of the majority, may lawfully apply the closure and cut off further debate; and it is no objection to the validity of a resolution that its passage was obtained in that way.⁵

§ 1279. **Repeal of Resolutions and Reconsideration of Votes.** — The shareholders may, of course, repeal any previous resolution, or rescind any previous action,⁶ unless such repeal or rescission would amount to a breach of contract or would violate the law or the company's regulations. But, further than this, it seems that any resolution may be reconsidered at any time during the session or meeting at which it was passed.⁷ Thus, where the

¹ *Triesler v. Wilson*, 89 Md. 169; L. J., in *Macdougall v. Gardiner*, 142 Atl. 926. Cf. supra, § 1275.

² *Argus Printing Co.*, 1 N. Dak. 434, 449; 48 N. W. 347; 26 Am. St. Rep. 639 (semble).

Cf. *Lighthall Mfg. Co.*, 47 Hun 258, 263-264.

³ *State v. Chute*, 34 Minn. 135; 24 N. W. 353.

⁴ *Wall v. London, etc. Assets Corp.* (1898), 2 Ch. 469, 480 (semble); *Hill v. Atlantic, etc. R. R. Co.* (N. Car.), 55 S. E. 854, 859 (semble).

The sarcastic remarks of James, (Mo.), 99 S. W. 502 (where a reso-

holder's supposed right "of exercising his power of eloquence to induce the others to listen to him and to take his view" can hardly be deemed judicial authority to the contrary.

⁵ *Wall v. London, etc. Assets Corp.* (1898), 2 Ch. 469.

⁶ See *Terry v. Eagle Lock Co.*, 47 Conn. 141.

⁷ Cf. *P. B. Mathiason Mfg. Co.*

shareholders voted to confirm a contract for the sale to the directors of certain lands of the corporation, the court declared that the ratification might be rescinded at any time during the same session.¹ If this doctrine is sound, any resolution of the shareholders — even a resolution accepting an offer and making a contract — may be reconsidered until the shareholders have concluded or adjourned their session. Apart from any question of reconsideration by the shareholders collectively, any individual shareholder, even when the voting is by ballot, may change his vote at any time before the result is announced,² but not afterwards.³

§ 1280-§ 1288. *Control of Courts over Company Meetings.*

§ 1280. **In general — Exception to Rule of *Foss v. Harbottle*.** — The extent to which the courts will intervene in corporate meetings and votes, and the manner of their intervention is important to be considered. It has already been shown that cases where the question relates to the legality of the conduct of a general meeting should constitute an exception to the rule in *Foss v. Harbottle*.⁴

§ 1281. **Power of Courts to require Meetings to be held.** — The power of a court of equity to direct a meeting of shareholders to be held has been considered above.⁵ So, too, the power of a court of law to compel the convening of a meeting has been already mentioned.⁶

§ 1282. **Enjoining Meetings of Shareholders.** — Cases are not lacking in which a court of equity has enjoined the holding of a general meeting;⁷ but in view of the fact that the shareholders or proprietors of the company are thus restrained from their only means of controlling the management of their own

lution to reconsider an election of directors and proceed to another election was declared proper).

¹ *Cumberland Coal, etc. Co. v. Sherman*, 20 Md. 117, 149 (headnote inadequate).

² *State ex rel. Lawrence v. McGann*, 64 Mo. App. 225.

³ *Forsyth v. Brown*, 33 Wkly. Notes Cas. (Pa.) 72.

⁴ *Supra*, § 1156.

⁵ *Supra*, § 1194.

⁶ *Ibid*.

⁷ Cf. *Brown v. Pacific Mail, etc. Co.*, 5 Blatchf. 525, 537, and cases cited *infra*.

As a chancellor has jurisdiction to enjoin the holding of a general meeting, mandamus will not lie from a superior court of law to compel him to dissolve such an injunction. *Chiera v. Brevoort*, 97 Mich. 638.

property, a very strong case should be made out in order to justify such drastic relief.¹ Certainly, the court will not grant the injunction because the objects of the meeting *may* be carried out in an *ultra vires* manner.² So, too, a court will not enjoin a meeting for which no sufficient notice has been given to the shareholders;³ for if all the shareholders attend, the meeting will be valid.⁴ And, clearly, the mere appointment of a receiver and a sale of the company's property by him does not prevent the shareholders from holding a meeting and electing directors,⁵ nor justify the court in assuming control over the meeting or in directing that it be postponed.⁶ On the other hand, where the proposed meeting is to be held hastily, before certain transferees of shares can qualify as voters, for the fraudulent purpose of preventing them from getting control of the company, the injunction will be granted.⁷ Moreover, where directors have issued shares for the mere purpose of enabling their own party to carry out a scheme for altering the company's articles, the court enjoined the holding of a meeting for the purpose of confirming the resolution making the alteration.⁸ So, also, where the notice convening a meeting contained a misleading statement of the business to be transacted, the court enjoined the meeting.⁹ Moreover, where the right to vote upon the majority of the com-

¹ *Isle of Wight Ry. Co. v. Tachourdin*, 25 Ch. D. 320.

See also *Southern Plank Road Co. v. Hixon*, 5 Ind. 165.

² *Isle of Wight Ry. Co. v. Tachourdin*, 25 Ch. D. 320; *Mason v. Motor Traction Co.* (1905), 1 Ch. 419, 426 (where Buckley, J., said: "The company may meet and discuss anything they like. When they have arrived at a conclusion, there will arise for the first time the question whether such resolution as they pass can legally be carried into effect").

³ *Gold Bluff Mining, etc. Corporation v. Whitlock*, 75 Conn. 669, 675 (headnote inadequate); 55 Atl. 175.

But see *Jackson v. Munster Bank*, 13 L. R. Ir. 118.

⁴ See *supra*, § 1210.

⁵ *State v. Marchant*, 37 Oh. St. 251.

⁶ *Taylor v. Philadelphia, etc. R. Co.*, 7 Fed. 381.

⁷ *Cannon v. Trask*, 20 Eq. 669; *Archer v. American Water Works Co.*, 50 N. J. Eq. 33; 24 Atl. 508.

But see *Becher v. Wells Flouring Mill Co.*, 1 Fed. 276 (where the transfer was not absolute but by way of collateral security merely).

⁸ *Punt v. Symons & Co.* (1903), 2 Ch. 506 (*Quære*, whether the better course would not have been to enjoin the holders of the fraudulently issued shares from voting at the meeting).

⁹ *Jackson v. Munster Bank*, 13 L. R. Ir. 118.

But see *Gold Bluff Mining, etc. Corporation v. Whitlock*, 75 Conn. 669, 675; 55 Atl. 175 (stated *supra* in text).

pany's shares is in litigation, a court of equity may enjoin the holding of an election of directors until the question can be determined.¹

§ 1283. **Appointment of Master to supervise Meeting.** — Instead of wholly enjoining the meeting, chancery has sometimes assumed jurisdiction to appoint a master for the special purpose of presiding over and conducting the meeting, where it appeared that otherwise fraud and violence would occur.²

§ 1284. **Enjoining Shareholders from Voting.** — A court of equity has power to compass practically even more serious results than the prevention of a shareholders' meeting by enjoining all or some of the shareholders from participating therein, and thereby, perhaps, reversing what would otherwise have been the action of the meeting. For equity may enjoin a registered shareholder from voting at a general meeting where the circumstances would render his voting inequitable.³ But the particular shareholder to be enjoined must be a defendant to the suit and be served with process, and have an opportunity to be heard in his defence,⁴ — he is not sufficiently represented for this purpose

¹ *Villamil v. Hirsch*, 138 Fed. 690; 143 Fed. 654.

² *Tunis v. Hestonville, etc. R. R. Co.*, 149 Pa. St. 70; 24 Atl. 88; 15 L. R. A. 665; *Bartlett v. Gates*, 118 Fed. 66.

Cf. *Dick v. Lehigh Valley R. R. Co.*, 4 Pa. Dist. Rep. 56; *Walker v. Johnson*, 17 App. D. C. 144, 166-169 (where the court supervised the counting of the votes and enjoined the rejection of lawful proxies).

³ Cf. *Wood v. Union Gospel, etc. Ass'n*, 63 Wisc. 9; 22 N. W. 756; *Way v. American Grease Co.*, 60 N. Y. Eq. 263; 47 Atl. 44; *Reed v. Jones*, 6 Wisc. 680; *Memphis, etc. R. R. Co. v. Woods*, 88 Ala. 630; 7 So. 108; 16 Am. St. Rep. 81; 7 L. R. A. 605; *Harper v. Smith*, 93 N. Y. App. Div. 608; 87 N. Y. Supp. 516; *Luther v. C. J. Luther Co.* (Wisc.), 94 N. W. 69; 118 Wisc. 112; 99 Am. St. Rep. 977 (where shares were issued for the purpose of perpetuating the control of the then directors); *Bigelow v. Calumet, etc.*

Mining Co., 155 Fed. 869 (defendant restrained from voting shares acquired in pursuance of a scheme to create a monopoly); *Southern Electric Securities Co. v. State* (Miss.), 44 So. 785 (same point, the state being the complainant); and cases cited infra. Such relief may be granted although the company is in the hands of a receiver appointed by another court. *George v. Central R. R., etc. Co.*, 101 Ala. 607; 14 So. 752.

See *Converse v. Hood*, 149 Mass. 471; 21 N. E. 878; 4 L. R. A. 521; *Oelbermann v. N. Y., etc. Ry. Co.*, 77 Hun (N. Y.) 332; 29 N. Y. Supp. 545 (where the injunction was refused).

Quære, whether a court of law will by mandamus enforce a shareholder's right to vote. Cf. *Attorney-General v. Albion Academy*, 52 Wisc. 469; 9 N. W. 391.

⁴ Cf. *Hilles v. Parrish*, 14 N. J. Eq. 380; *Lucas v. Milliken*, 139 Fed. 816 (dissolving a preliminary injunction).

either by the other shareholders or the corporation.¹ A defendant who is properly before the court may, however, be enjoined from voting as proxy for persons who are not parties to the case.² A result of this power of chancery is that an election of directors by a minority of the whole number of shares may be legal although it is effected by means of an injunction excluding the holders of the other shares from voting;³ and accordingly where a trustee under a voting trust is apprehensive lest certain of his *cestuis que trust* on the eve of an important meeting should obtain by false allegations an *ex parte* injunction restraining him from voting, a court of equity will at his instance enjoin the *cestuis que trust* from resorting to such a trick.⁴ It has been held that the power to enjoin a shareholder from voting will be exercised where a court of law has established the title of a certain claimant to shares of stock, and the defeated parties have taken appeal, giving sufficient bond, etc., to operate as a stay; for in such a case, it was held, the appellants may file a bill for an injunction against the successful party below to restrain him from voting on the shares pending the appeal.⁵ On the other hand, where a proceeding is instituted to rescind a transfer of shares on account of fraud of the transferee, it has been held that although, *pendente lite*, the transferee may be enjoined from assigning the shares, yet he should not be enjoined from voting on the shares.⁶ The truth is, each case should be governed by its own facts; but the injunction should not be granted unless serious injury is likely to result from allowing the defendant to vote.

An injunction against transferring shares will not prevent the legal holder from voting on them;⁷ and conversely an injunc-

¹ *Brown v. Pacific Mail, etc. Co.*, 5 Blatchf. 525, 533; *Taylor & Co. v. Southern Pac. Co.*, 122 Fed. 147; *Jones v. Nassau Suburban Home Co.*, 103 N. Y. Supp. 1089; 53 N. Y. Misc. 63.

But see *Ayer v. Seymour*, 15 Daly (N. Y.) 249; 5 N. Y. Supp. 650.

² *Brown v. Pacific Mail, etc. Co.*, 5 Blatchf. 525.

³ *Rochester Dist. Tel. Co.*, 40 Hun (N. Y.) 172; *Brown v. Pacific Mail, etc. Co.*, 5 Blatchf. 525.

Cf. *Lucas v. Milliken*, 139 Fed. 816 (where in dissolving a preliminary injunction which had been

trickily used to enable a minority to retain control of a corporation, the court forcibly pointed out the danger of granting such injunctions without the fullest knowledge of the facts); *Villamil v. Hirsch*, 143 Fed. 654; 138 Fed. 690.

⁴ *Brown v. Pacific Mail, etc. Co.*, 5 Blatchf. 525.

⁵ *Durfee v. Harper*, 22 Mont. 373; 56 Pac. 589.

⁶ *Maine Products Co. v. Alexander*, 115 N. Y. App. Div. 112.

⁷ *Commonwealth v. Stevens*, 168 Pa. St. 582; 32 Atl. 111.

tion against voting in respect of shares will not prevent the defendant from exercising any other rights of ownership — such as the right to file a shareholder's bill.¹

§ 1285. **Compelling Shareholder to execute a Proxy.** — Cognate with the power of enjoining a shareholder from voting is the power of compelling him to execute a proxy.² For instance, if a court of equity has appointed a receiver of an estate which includes shares in a corporation, the owner may properly be required to execute a proxy to the receiver, lest he himself should take advantage of the right to vote to render the property of no value.³

§ 1286. **Enforcing the Counting of legal Votes.** — It has been held that mandamus will lie to compel canvassers or scrutineers to perform the duty cast upon them by law of counting legal votes.⁴

§ 1287. **When Courts will reverse Action of Meeting — Effect of illegal Reception or Rejection of Votes, Disqualification of Candidate, Mistake in Count of Votes, etc.** — The reception of illegal votes will not invalidate an election or other action of a general meeting unless they were numerous enough to affect the result;⁵ and not even in that case, according to some authorities, unless the votes were challenged at the time.⁶ For a like reason, in order to invalidate an election there must be affirmative proof that the illegal votes were cast in favor of the candidate returned as elected.⁷ And, generally, the courts will be slow to set aside an election or resolution on account of mere irregularities, where the sense of the meeting appears to have been substantially and

¹ *Maine Products Co. v. Alexander*, 115 N. Y. App. Div. 475.

² See *supra*, § 1223.

³ *Atkinson v. Foster*, 27 Ill. App. 63.

⁴ *State ex rel. Lawrence v. McGann*, 64 Mo. App. 225.

⁵ *Chenango Co.*, 19 Wend. (N. Y.) 635; *Wardens of Christ Church v. Pope*, 8 Gray (Mass.) 140, 143;

Madison Ave. Baptist Church v. Baptist Church, 5 Rob. (N. Y.) 649;

First Parish v. Stearns, 21 Pick. 148; *Argus Co.*, 138 N. Y. 557; 34 N. E.

388; *Conant v. Millaudon*, 5 La. Ann. 542, 543-544 (headnote inad-

quate); *People v. Tuthill*, 31 N. Y. 550; *Trustees, etc. v. Gibbs*, 2 Cush. (Mass.) 39, 45; *Byers v. Rollins*, 13

Colo. 22; 21 Pac. 894; *State v. Lehre*, 7 Rich. Law (S. Car.) 234,

325; *McNeely v. Woodruff*, 13 N. J. Law 352.

⁶ *Chenango Co.*, 19 Wend. (N. Y.) 635.

Cf. *Wardens of Christ Church v. Pope*, 8 Gray (Mass.) 140; *State v. Lehre*, 7 Rich. Law (S. Car.) 234,

325-326; *Hartt v. Harvey*, 32 Barb. (N. Y.) 55.

⁷ *Ex parte Murphy*, 7 Cow. (N. Y.) 153.

fairly ascertained.¹ An election will not be set aside because of the reception of votes which were in fact legal although on the evidence as presented to the inspectors they ought to have been rejected.² But an election is irregular if enough votes to have given another candidate a majority were rejected, even if that other candidate was disqualified.³

Some authorities hold that where votes have been wrongfully rejected, the court can only declare the resolution or election invalid, and has no power to count the rejected votes in favor of the side for which they would have been cast;⁴ but this seems a narrow view, and perhaps the weight of authority as well as of reason is contra.⁵ In New Jersey, the rule adopted is that where the votes wrongfully rejected would have given the party for which they were offered a majority of the company's entire capital, the court will count the votes for that party and order accordingly, but that where the rejected votes would have given a majority of the shares represented at the meeting, but not of all the shares, the court will merely order a new meeting.⁶

Where, at an election for directors, an unqualified person receives a majority of the votes legally cast, the court will, it seems, merely order a new election, and will not declare elected the candidate receiving the next highest number of votes — a minority of the total vote cast.⁷

¹ Cf. *Phillips v. Wickham*, 1 Paige (N. Y.) 590, 600.

² *Conant v. Millaudon*, 5 La. Ann. 542.

Cf. *supra*, § 1275.

³ *State v. New Orleans, etc. Co.*, 20 La. Ann. 489, 494-495 (headnote inadequate). See also cases cited *infra*, note 7.

⁴ *Long Island R. R. Co.*, 19 Wend. (N. Y.) 37, 45; 32 Am. Dec. 429 (semble); *State v. McDaniels*, 22 Oh. St. 354, 369; *People v. Phillips*, 1 Denio (N. Y.) 389.

⁵ *State v. Smith*, 15 Oreg. 98; 14 Pac. 814; 15 Pac. 137, 386.

Cf. *St. Lawrence Steamboat Co.*, 44 N. J. Law 529; *Walker v. Johnson*, 17 App. D. C. 144, 166-169.

⁶ *Cape May, etc. Nav. Co.*, 51 N. J. Law 78; 16 Atl. 191.

⁷ *St. Lawrence Steamboat Co.*, 44 N. J. Law 529, 535; *Stratford v. Mallory*, 58 Atl. 347; 70 N. J. Law 294; *Jersey City Paper Co.*, 55 Atl. 280; 69 N. J. Law 594. Cf. *Horton v. Wilder*, 48 Kans. 222; 29 Pac. 566. In regard to the similar question as to elections of public officers the courts are divided in opinion: the English courts and some American authorities hold that the candidate who receives the next highest number of votes is elected, while many other American courts hold that the disqualification of the candidate who receives the highest number of votes vitiates the election altogether. See McCrary on Elections, § 327-§ 331, and cases cited in 15 CYC., p. 391, tit. "Elections," XV, C (1); 10 Am. & Eng. Enc. of

Of course, where an election is properly held, the only error being committed in the count, the right and duty of the courts is to correct the error and install the person who in fact received a majority.¹

Where the shareholders contemporaneously assemble in two bodies but at the same place, and two polls are held for the election of directors, both of which have apparently an equal title to be considered the lawful meeting, the court in ascertaining who were legally elected will count the votes cast at both of the polls, and decide in favor of the candidates having a majority of the total vote.² Where votes have been offered by the legal but not the equitable owner, although they ought legally to be counted yet a court in the exercise of its discretion may refuse to issue a mandamus to install as directors the persons elected by such votes.³

§ 1288. **Remedies for Testing Validity of Election of Directors.** — Perhaps the most important matter which comes before shareholders' meetings is the choice of directors. The remedies by which a person who claims to be legally entitled to the office of director may test the validity of his title will be considered below.⁴

§ 1289. **Whether Irregularities in General Meetings affect Third Persons** — **Application of Rule of Royal British Bank v. Turquand.** — By no means every irregularity in the conduct of a shareholders' meeting will render the proceedings invalid as against innocent third parties who have no notice of the informality. On the contrary, the majority of the shareholders of a corporation may be deemed agents of the imaginary corporate entity, and the rules of procedure prescribed for their action by law or by the company's regulations may be regarded as so many instructions given to them by their principal, non-compliance with which

Law, 2d ed., p. 758, tit. "Elections," XV (4).

As to election of disqualified person to be a director, see further infra, § 1412. Cf. *State v. New Orleans, etc. Co.*, 20 La. Ann. 48 (stated supra in text).

¹ *Tomlin v. Farmers' Bank*, 52 Mo. App. 430.

² *Cedar Grove Cemetery Co.*, 61 N. J. Law 422; 39 Atl. 1024.

³ *Wentworth Co. v. French*, 176 Mass. 442; 57 N. E. 789.

⁴ *Infra*, § 1508.

will accordingly not necessarily invalidate their action as against a third person who in good faith without knowledge of the irregularity relies upon their action. In other words, the same principles which are somewhat elaborately considered below with reference to the effect of irregular action by the directors¹ apply to similar irregular action by a shareholders' meeting. The rule in *Royal British Bank v. Turquand* applies to shareholders as well as to directors. Thus, debentures issued by a shareholders' meeting which was not attended by a quorum will nevertheless be valid in the hands of holders who took without notice of the irregularity.²

These principles have been applied to directors much more often than to shareholders, because it is comparatively seldom that shareholders' meetings purport to enter into contracts on behalf of the company, or to pass other resolutions upon which the rights of third parties rest. Most often, the validity of action taken at general meetings of corporations is called in question in controversies between shareholders who were fully cognizant of the facts, so that the rights of persons *bona fide* contracting or dealing with the company in ignorance of any irregularity cannot be involved.

§ 1290-§ 1294. *Action of Shareholders without a Meeting.*

§ 1290. **In general.** — It is clear that the action or assent of a mere majority of the shareholders taken separately and not in a meeting cannot be deemed (except perhaps as to persons without notice of the irregularity³) the act of the corporation.⁴ For this

¹ *Infra*, § 1473-§ 1476.

² *Romford Canal Co.*, 24 Ch. D. 85. Cf. *Heiton v. Waverley Hydro-pathic Co.*, 4 Rettie Sc. 830. Cf. *infra*, § 1290 et seq., and *supra*, § 1210.

³ See *supra*, § 1289.

⁴ *Commonwealth v. Cullen*, 13 Pa. St. 133; 53 Am. Dec. 450; *Langolf v. Seiberlitch*, 2 Pars. Eq. (Pa.) 64; *Peirce v. New Orleans Bldg. Co.*, 9 La. 397; 29 Am. Dec. 448; *Duke v. Markham*, 105 N. Car. 131; 10 S. E. 1017; 18 Am. St. Rep. 889; *Nicholson City Co. v. Smalley*, 21 Tex.

Civ. App. 210; 51 S. W. 527; *African M. E. Union Church*, 28 Pa. Super. Ct. 193; *Taylor v. R. D. Scott & Co.* (Mich.), 113 N. W. 32.

Cf. *Sylvania, etc. R. Co. v. Hoge* (Ga.), 59 S. E. 806 (holding that where the directors who attend a shareholders' meeting proceed then and there to hold a board meeting, action taken by them at the board meeting cannot be treated as action of a shareholders' meeting, although had they purported to act as shareholders, the action would have been valid).

reason, proceedings at a shareholders' meeting of which the required notice was not given are void.¹ So, it has been held that the individual assents of shareholders to a present to one of the directors cannot bind the corporate body.² If, however, *all* the shareholders concur in a particular action, it would seem that the formality of a meeting may be dispensed with.³ But the contrary has been declared by high authority. Thus, the United States Supreme Court has said that a transfer of the corporate assets made in the company's name would not be "within the powers of the stockholders even though they all signed it, without formal action of a meeting held for that purpose."⁴ All authorities agree, however, that a gathering of all the members of a company at one place may take valid action as a shareholders' meeting although no formal call or notice of the meeting was given.⁵ Of course, any action taken by the shareholders unanimously but without a meeting must in order to be valid be *intra vires* of the company; and this is not the case where the shareholders act not for the furtherance of the company's business but for the advancement of their own fortunes. In order that any effect may be given to such action, with respect to the corporate assets, the court must disregard the corporate

¹ *Garden Gully Mining Co. v. McLister*, 1 A. C. 39; *Smyth v. Darley*, 2 H. L. Cas. 789. See also *supra*, § 1210.

But see *Jones v. Hilldale Cementery Soc.* (Ky.), 65 S. W. 838.

² *George Newman & Co.* (1895), 1 Ch. 674.

³ *Bundy v. Iron Co.*, 38 Oh. St. 300; *Coe v. East & West R. R. Co.*, 52 Fed. 531, 555-556; *Ten Eyck v. Pontiac, etc. R. R. Co.*, 74 Mich. 226, 234 (headnote inadequate); 41 N. W. 905; 16 Am. St. Rep. 633; 3 L. R. A. 378; *Jordan, etc. Co. v. Collins, etc. Co.*, 107 Ala. 572; 18 So. 137; *Kalamazoo Spring, etc. Co. v. Winans*, 106 Mich. 193; 64 N. W. 23 (chattel mortgage executed with consent of all the shareholders valid); *M. Groh's Sons v. Groh*, 80 N. Y. App. Div. 85; 80 N. Y. Supp. 438 (dividends declared by mere informal agreement among shareholders);

Mackey v. Burns, 64 Pac. 485; 16 Colo. App. 6; *Riesterer v. Horton Land, etc. Co.*, 160 Mo. 141; 61 S. W. 238; *Lemars Shoe Co. v. Lemars Shoe Mfg. Co.*, 89 Ill. App. 245; *Aransas Pass, etc. Co. v. Manning*, 63 S. W. 627; 94 Tex. 558.

See also the arguments advanced with respect to the analogous case of unanimous action by directors. *Infra*, § 1465.

⁴ *De LaVergne Co. v. German Savings Inst.*, 175 U. S. 40, 53; 20 Sup. Ct. 20.

See also *Baldwin v. Canfield*, 26 Minn. 43; 1 N. W. 261, 276; *Finley Shoe, etc. Co. v. Kurtz*, 34 Mich. 89; *Dennis v. Joslin Mfg. Co.*, 19 R. I. 666; 36 Atl. 129; 61 Am. St. Rep. 805; *Demarest v. Spiral Riveted Tube Co.* (N. J.), 58 Atl. 161; 71 N. J. Law 14; *Sellers v. Greer*, 172 Ill. 549.

⁵ See *supra*, § 1210.

entity altogether and treat the corporation as a phantom. This some courts in some cases have done.¹

§ 1291. **Application to One-Man Companies — Tendency of predominant Shareholder to disregard corporate Fiction and act in his own Name.** — This question as to action by shareholders without a meeting, or a very similar question, is often raised with respect to so-called "one-man companies,"² where all or practically all the shares are held by one man. In such cases, in practice, the veil of the corporate fiction is often brushed aside, and action is taken by the predominant shareholder in his own name. So, too, wherever the company is small and the shareholders few, there is always a likelihood that the shareholders, being agreed touching some matter, may think it unnecessary to go through the formality of a meeting. On principle, there would seem to be little difference between these two cases; but undoubtedly the courts are more likely in the former case than in the latter to regard the corporation as a shadow and to treat the action of the shareholders as equivalent to the formal action of a corporate meeting. In both cases, it should be observed, the difficulty is not merely that the shareholders acted without a regular meeting, but also that they acted in their own name and on their own behalf and did not purport to bind the company, whose existence they assumed to ignore.

§ 1292. **Cases where formal Error is fatal — Deed not in Corporate Name — Actions or Suits not in Corporate Name.** — The last mentioned difficulty is in some cases necessarily fatal. For instance, a deed in order to convey the legal title to property belonging to a corporation must be made in the corporate name and under the corporate seal; and hence a deed made by all the shareholders in their own names cannot pass the legal title.³ This result would be reached even upon the doctrine that the unanimous assent of the shareholders, although not given at a shareholders' meeting, may nevertheless bind the company. The defect is in the form of the instrument, not in lack of authority to bind the company in those by whom it was executed. Thus, although it be true that a deed under the company's name and seal will be a good conveyance of legal title if au-

¹ *Infra*, § 1293.

³ *Wheelock v. Moulton*, 15 Vt.

² As to which see *supra*, Chapter 519 (note that this case was in XVII.

equity).

thorized by the shareholders unanimously though without a meeting, nevertheless if the deed were made in the names of the shareholders, it could not convey the legal title to property of the corporation. Such a deed, therefore, being on its face wholly void as respects corporate property cannot, it has been held in Minnesota, constitute a cloud on the title thereto.¹ In the same way, an action or suit, in order that the company may be a party, must be in the corporate name; and it is not sufficient that all the shareholders, in meeting or otherwise, may have authorized it.² The law requires a certain form, which must be observed.

§ 1293. **Deeds in Names of Shareholders as simple Contracts of the Corporation.** — Because deeds and conveyances executed by all the shareholders in their own names cannot transmit legal title from the corporation, it does not follow that the same instruments may not be operative as executory contracts of the company, and so pass an equitable title.³ If the views advocated above are sound, it would be no objection to so holding that the unanimous assents of the shareholders to the transaction were given separately and not at a general meeting. But an additional and theoretically troublesome obstacle is that the shareholders acted for themselves and not on the company's behalf, and did not intend to perform a corporate act. Some courts have accordingly held that not even unanimous action of the shareholders on their own behalf, without a meeting, and without an intention to act as a corporation, can bind the company even by way of simple contract, or in equity.⁴ But, as already intimated, the contrary would be held in other jurisdictions.

¹ *Baldwin v. Canfield*, 26 Minn. 43, 58; 1 N. W. 261, 276. *Quære*, *McShea Amusement Co.* (N. J.), 60 Atl. 419.

² Whether this case should have been decided differently if the deed, as argued *infra*, § 1293, could be regarded as a simple contract of the corporation.

³ In *Rough v. Breitung*, 117 Mich. 48; 75 N. W. 147, the plaintiff seems to have committed a mistake in disregarding this rule.

⁴ In *Bundy v. Iron Co.*, 38 Oh. St. 300; *First Nat. Bank v. Winchester*, 119 Ala. 168; 24 So. 351; 72 Am. St. Rep. 904; *Clement v. Young-*

Wheelock v. Moulton, 15 Vt. 519. See *Baldwin v. Canfield*, 26 Minn. 43; 1 N. W. 261, 276; *Sellers v. Greer*, 172 Ill. 549; 50 N. E. 246; 40 L. R. A. 589; *Dennis v. Joslin Mfg. Co.*, 19 R. I. 666; 36 Atl. 129; 61 Am. St. Rep. 805; *Watson v. Bonfils*, 116 Fed. 157; 53 C. C. A. 535; *Palmer v. Ring*, 113 N. Y. App. Div. 643 (bill of sale executed individually by president, who owned substantially all the stock of corporation, held to pass no title).

Thus, where a sole shareholder makes a deed of corporate property in his own name, the company has been held to be bound thereby in equity as against all persons having notice thereof.¹ Perhaps, some courts would reach the same conclusion, if all the members of any corporation united in attempting to convey the company's property by a deed in their individual names. The recording of a deed of that character ought not, however, to operate as constructive notice as against persons dealing with the company;² for the deed would not be indexed under the corporate name and persons examining the records would therefore be unable to discover it.

Any such contract by the shareholders should be unenforceable against the company if, treated as a contract of the corporation, it is *ultra vires* or otherwise unlawful.³ Consequently, where the action is taken by the shareholders not for the objects of the corporation and therefore not *intra vires* of the company, but for their own private ends, — for instance, where they attempt to mortgage its property to secure their individual debts, — effect cannot be given to their action even in equity, except indeed by throwing overboard the whole law of corporations and treating the company as a mere partnership. Some courts in the case of one-man companies have gone even to this length;⁴ but others have refused to do so.⁵ If any such equity is to be recognized, it should at all events never be applied against persons dealing with the company in regular course, such as creditors, or pledgees of shares, who had no notice of the "equity."

¹ *Swift v. Smith*, 65 Md. 428; 5 Atl. 534; 57 Am. Rep. 336.

² *Bundy v. Iron Co.*, 38 Oh. St. 300, 302 (semble). The dictum to the contrary in *Swift v. Smith*, 65 Md. 428, 434, 436—437, can be explained on the ground that the deed in that case did purport to be a deed of the corporation, and was doubtless recorded and indexed as such.

³ *Rough v. Breitung*, 117 Mich. 48 (headnote inadequate); 75 N. W. 147.

⁴ *Swift v. Smith*, 65 Md. 428; 5 Atl. 534; 57 Am. Rep. 336 (where

the company was composed of a single shareholder); *First Nat. Bank v. Winchester*, 119 Ala. 168; 24 So. 351; 72 Am. St. Rep. 904 (where the corporation consisted of two members); *American Fruit Co. v. Ward*, 99 N. Y. Supp. 717; 113 N. Y. App. Div. 319 (headnote inadequate).

⁵ *Parker v. Bethel Hotel Co.*, 96 Tenn. 252; 34 S. W. 209; 31 L. R. A. 706; *Baldwin v. Canfield*, 26 Minn. 43; 1 N. W. 261, 276.

Cf. *Sellers v. Greer*, 172 Ill. 549; 50 N. E. 246; 40 L. R. A. 589.

§ 1294. **Whether Action by less than all the Shareholders individually can bind their Proportion of the Company's Property.** — The authorities cited in the last section must carefully be confined to cases where all, or at any rate practically all, of the shareholders unite in the contract or other action. For, it is well settled that one of several shareholders cannot bind the company by contract; neither can he convey the corporate property or any interest therein. He cannot even assign his own indirect interest in the property of the corporation, except by a transfer of his shares. Any attempt by a shareholder, even by the holder of a majority of the company's shares, to transfer title to assets of the corporation or his supposed interest therein is wholly nugatory both at law and in equity.¹ The only troublesome question arises when all the shareholders have united in such action, in which case the court must determine whether their proceeding cannot be treated as a corporate act, *ut res magis valeat quam pereat*.

§ 1295. **Laches and Acquiescence of Shareholders.** — The law is now settled that a corporation may be bound by the acquiescence or laches of its shareholders² even though they may have held no meeting at which action might have been taken.³ Ordinarily, when the shareholders have been guilty of laches or tacit acquiescence, the same might be predicated of the officers and directors; and we have already seen that the laches or non-action of directors is imputable to the corporation. In all such cases, an inquiry whether the same principle applies to the share-

¹ *Humphreys v. McKissock*, 140 U. S. 304; 11 Sup. Ct. 779. Cf. *National Hollow, etc. Co. v. Chicago Ry., etc. Co.*, 80 N. E. 556; 226 Ill. 28; *Sellers v. Greer*, 172 Ill. 549 (contract between two persons who together owned the entire stock of a corporation, except two shares nominally outstanding, whereby one agreed to convey to the other his interest in the company's property).

² *Beecher v. Marquette, etc. Co.*, 45 Mich. 103; 7 N. W. 695; *Gar-* *many v. Lawton*, 124 Ga. 876; 53 S. E. 669; 110 Am. St. Rep. 207. ³ *Miller v. Matthews*, 87 Md. 464; 40 Atl. 176; *Colonial Bank v. Wil-lan*, 5 P. C. 417; *Rosehill Cemetery Co. v. Dempster*, 79 N. E. 276, 280 (headnote inadequate); 223 Ill. 567 ("It is not necessary that a meeting of shareholders be held in order to ratify an illegal act of the board of managers").

Cf. *Re Atheneum Society*, 4 K. & J. 558, 562-563.

holders is immaterial. But that the principle really does apply to the shareholders is made evident by a number of exceptional cases, — for instance, where the shareholders are held to have approved by acquiescence irregular or improper action by the directors,¹ or where for any other reason action would be beyond the powers of the directors and could only be taken by the shareholders.² In theory, a company should not be affected by laches or acquiescence of its shareholders unless a general meeting has been held at which action might have been taken, or unless the laches or acquiescence can be predicated of *all* of the shareholders.³ The same remarks already made in connection with this subject in respect to the laches or acquiescence of directors are equally appropriate here. The tendency is and should be to draw the same inference from inaction in the case of a corporation as would be permissible if the company were an individual.

¹ *Infra*, § 1589.

Cf. *Aurora, etc. Society v. Paddock*,

² *Payson v. Stoeber*, 2 Dill. 427; 80 Ill. 263.

Robinson Mineral Spring Co. v.

³ *Beaconsfield Heights Estate Co., DeBautte*, 50 La. Ann. 1281; 23 So. 22 Viet. L. R. 97, 101. 865.

CHAPTER XXII

POWERS OF MAJORITY—RELATION OF SHAREHOLDERS TO THE COMPANY

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§ 1296–§ 1300. *Limitations on Powers of Majority — Control of Individual Shareholder over Management of the Company.*

§ 1296. **Limits of Powers of Majority in general.** — That the majority rules is axiomatic in the law of corporations. To this principle there are but three exceptions or limitations. (1) The

action of the majority, to be valid, must be within the powers of the corporation — that is to say, not *ultra vires* of the company. (2) The majority may be expressly restrained by statute or by a valid regulation of the company from exercising some power which is conferred upon the corporation, the assent of two thirds or three fourths of the shareholders, or some other proportion greater than a mere majority, being required. (3) The majority must act honestly and not fraudulently;¹ for while the majority, however mistaken they may be in respect to the course dictated by the interests of the company, cannot be controlled so long as they confine themselves within the powers of the corporation and their own powers (which with the exception just mentioned are co-extensive with the powers of the corporation),² yet if they are actuated by fraudulent motives, the courts will treat their action as in excess of their powers.

§ 1297. **Veto of individual Shareholder upon Actions by Majority in excess of their Powers.** — In all these three cases — that is to say, wherever the majority attempt to do that which is *ultra vires* of the corporation, or that which although not beyond the powers of the company as a whole is yet expressly prohibited to a mere majority, or that which is fraudulent and not by them honestly deemed for the best interests of the company — in all these cases, the majority commit a wrong against the corporation for which on the principles stated elsewhere any shareholder may step in and sue for redress by means of a shareholder's bill.³ In other words, every shareholder has a veto upon any action of the majority which is either in excess of the powers of the corporation or in excess of their own powers or fraudulent. Apart, of course, from the right to vote at a general meeting, a shareholder's only control over the management of the company consists in this veto upon either *ultra vires* or fraudulent actions on the part of the majority.⁴

¹ As to the meaning of "fraud" in this connection, see *McLeary v. Erie Telegraph, etc. Co.*, 38 N. Y. Misc. 3; 76 N. Y. Supp. 712.

² *Farwell v. Babcock* (Tex.), 65 S. W. 509; 27 Tex. Civ. App. 162; *Manufacturers' Land, etc. Co. v. Cleary* (Ky.), 89 S. W. 248; *Figge v. Bergenthal* (Wisc.), 109 N. W. 581; 110 N. W. 798.

³ *Supra*, § 1143-§ 1148.

⁴ *Shaw v. Davis*, 78 Md. 308; 28 Atl. 619; 23 L. R. A. 294; *Dudley v. Kentucky High School*, 9 Bush (Ky.) 576; *Phillips v. Providence Steam Engine Co.*, 21 R. I. 302; 43 Atl. 598; 45 L. R. A. 560.

§ 1298. **Actions of Majority which are Ultra Vires of the Corporation.** — Whether or not a transaction is *ultra vires* of the corporation depends, usually, almost entirely on questions of law which in so far as pertinent in this treatise have been already dealt with.¹ It should be borne in mind, however, that in this connection constitutional questions as to the power of the majority to accept legislative alterations of the charter must often be decided, and constitutional questions are outside the scope of this work.

§ 1299. **Express Restrictions on Powers of Majority within Powers of the Corporation — Regulations requiring two-thirds Vote, etc.** — Cases of restrictions on the powers of the majority within the power of the corporation turn upon express statutes or upon express provisions of incorporation papers,² and also depend almost wholly on questions of law. In such cases, the statutory proportion, two thirds or three fourths, or whatever it may be, is substituted for the majority, and if less than the required proportion, even though more than a majority, undertake to bind the company, their action is as nugatory as an attempt by a minority shareholder in the ordinary case to act or contract on behalf of the corporation. Moreover, as a mere majority of the shareholders are incompetent to ratify a transaction which they could not originally authorize, the corporation cannot be bound because by the acquiescence of the majority it has retained the benefits of the unauthorized transaction. In order to establish ratification on the part of the corporation, there must be proof that not merely a majority but two thirds or three fourths, or whatever the statutory proportion may be, have acquiesced in the transaction or in the retention by the company of the benefits derived therefrom.

§ 1300. **Fraudulent Actions of Majority — Difficulty in proving Fraud affirmatively.** — A contention that the majority are perpetrating a fraud on the company generally raises a dispute as to matters of fact which are oftentimes peculiarly difficult of proof. Fraud is never easy to prove affirmatively; and in corporate matters, where the opportunities for covering up rascality are but too frequent, adequate affirmative evidence is especially

¹ Supra, § 46-§ 108, and § 1154. A. 517 (lease of a railway required

² See *Rogers v. Nashville, etc. Ry.* to have consent of three fourths of Co., 91 Fed. 299, 314-316; 33 C. C. shareholders). Cf. § 1441.

hard to secure. The endeavor may, however, be materially lightened if only a presumption can be raised sufficient to shift the burden of proof to the other side. If, for instance, the majority stand in a fiduciary relation towards the company, or towards the minority, a charge that they are fraudulently mismanaging the corporation can be substantiated with comparative ease. Or, if the fact that the majority are interested in a particular matter adversely to the corporation may in law be relied upon as *prima facie* evidence of fraud, the case of the minority would be enormously simplified.

§ 1301—§ 1303. *Relation of Individual Shareholders to the Company.*

§ 1301. **In general.**—The general principle is well settled that an individual shareholder who is not an officer or director or promoter has no power to act as agent for the company although he own a large majority of its shares,¹ and stands in no fiduciary relation towards the corporation or towards his fellow members. A shareholder in a corporation is thus sharply differentiated from a member of a co-partnership; for a partner undoubtedly occupies a fiduciary relation towards the firm and his co-partners. But a reason for this distinction is found in the fact that each partner is an agent for the firm and has therefore a much greater power to bind his co-partners than a single shareholder in a corporation enjoys, who, as just stated, is not by virtue of being a shareholder an agent of the company.

¹ *Lawson v. Black Diamond, etc.* 372; *Morelock v. Westminster Water Co.* (Wash.), 86 Pac. 1120; *Tabor v. Bank of Leadville* (Colo.), 83 Pac. 1060; *Fairfield County Turnpike Co. v. Thorp*, 13 Conn. 173 (admissions of shareholder not evidence against corporation); *Clement v. Young-McShea Amusement Co.* (N. J.), 67 Atl. 82 (owner of majority of the capital stock); *Allemong v. Simmons*, 124 Ind. 199; 23 N. E. 768 (owner of majority of stock); *Hopkins v. Roseclaire Lead Co.*, 72 Ill. 373 (owner of majority of stock); *Harris v. Muskingum Mfg. Co.*, 4 Blackf. (Ind.) 267; 29 Am. Dec. 372; *Morelock v. Westminster Water Co.* (Md.), 4 Atl. 404; *Western Mining, etc. Co. v. Peytona Coal Co.*, 8 W. Va. 406, 432-433; *Jones v. Williams*, 37 L. R. A. 682; 139 Mo. 1; 39 S. W. 486; 40 S. W. 353; 61 Am. St. Rep. 436 (semble, owner of majority of stock). Cf. *supra*, § 1082. See also *Sellers v. Greer*, 172 Ill. 549 (contract between two persons owning together all except two shares). But see *Huntington Fuel Co. v. McIlwaine* (Ind.), 82 N. E. 1001 (action by owner of majority of shares).

On the other hand, the shareholder has an interest in the corporation, and the law will not altogether close its eyes to this fact. Thus, when a shareholder negotiates a purchase by his corporation of land belonging to a third person, the latter is justified in assuming that the shareholder is acting gratuitously because of his interest in the company; and hence it has been held that the shareholder cannot recover the usual broker's commissions from the vendor.¹

§ 1302. **Contracts between a Shareholder and the Corporation.**

— A corollary of the proposition that the several shareholders in a corporation are not fiduciaries is that each shareholder may contract with the company as freely as an entire stranger might do.² He is subject to no incapacity such as a director or officer or agent or even a promoter.³ Indeed, by the weight of authority the fact of his membership is in general no ground for suspecting the good faith of the transaction, and furnishes no cause for rescinding it.⁴ Moreover, the contract is not voidable because of mere failure frankly to disclose material facts, such, for instance, as the fact that a shareholder is interested in the contract.⁵ There must be such fraud as would vitiate a contract between two unrelated parties dealing at arm's length.⁶ A shareholder may purchase at a sheriff's sale property belonging to the company, even where the price is much less than its real value.⁷ It has even been said that a shareholder in dealing with his company is not charged with notice of irregularities in "indoor management," but is protected by the rule in *Royal British Bank v. Turquand*, to the same extent as a stranger

¹ *Steele v. Lawyer* (Wash.), 91 Pac. 958.

² *Langston v. Greenville, etc. Imp. Co.*, 120 N. Car. 132; 26 S. E. 644; *Russell v. Rock Run, etc. Gas Co.*, 184 Pa. St. 102; 39 Atl. 21; *Lexington, etc. Ins. Co. v. Page*, 17 B. Monr. (Ky.) 412, 439; *Burr v. McDonald*, 3 Gratt. (Va.) 215, 236.

³ Cf. *Bird Coal & Iron Co. v. Humes*, 157 Pa. St. 278; 27 Atl. 750; 37 Am. St. Rep. 727 (stated infra, § 1613); *Huntington Fuel Co. v. McIlwaine* (Ind.), 82 N. E. 1001.

⁴ *Gamble v. Queens County Water Co.*, 123 N. Y. 91; 25 N. E. 201;

9 L. R. A. 527; *Shaw v. Davis*, 78 Md. 308; 28 Atl. 619; 23 L. R. A. 294.

⁵ *Fox v. Mackay*, 125 Cal. 57, 64; 57 Pac. 670.

⁶ But see *Atwater v. American Exchange Bank*, 152 Ill. 605, 615-616; 38 N. E. 1017 (where the court said that a shareholder in making a contract with his company is held to a larger measure of candor and good faith than if he were not a shareholder).

⁷ *Meckles v. Rochester City Bank*, 11 Paige (N. Y.) 118; 42 Am. Dec. 103.

would be; but perhaps this doctrine is unduly favorable to the shareholder.¹

The principle of law by which dealings between a shareholder and his company have the same effect as if the parties were strangers, applies in favor of the company as well as against it. Thus, a corporation which purchases property from a shareholder is not necessarily charged with notice of an unrecorded mortgage executed by the grantor, unless the circumstances be such that the company can be regarded as a mere agency of the shareholder and not an independent organization.²

§ 1303. **Voting Rights of Shareholder interested adversely to the Company and to the other Shareholders.** — Moreover, a shareholder is not debarred from voting at a general meeting upon a matter in which his individual interest is or may be adverse to that of the company,³ and the action of the meeting is not invalidated because the decisive votes were the votes of the interested shareholder.⁴ Indeed, his voting rights are deemed property rights, and, accordingly, he is at liberty to vote in the way he may deem conducive to his own interests although hostile to the interests of the company at large.⁵

¹ *Gordon v. Preston*, 1 Watts (Pa.) 385, 387 (semble).

See *infra*, § 1476.

² *International Wrecking, etc. Co. v. McMorran*, 73 Mich. 467 (headnote inadequate); 41 N. W. 510. Cf. *supra*, § 348, § 1089.

³ *Gamble v. Queens County Water Co.*, 123 N. Y. 91; 25 N. E. 201; 9 L. R. A. 527; *Windmuller v. Standard Distilling, etc. Co.*, 114 Fed. 491; *Shaw v. Davis*, 78 Md. 308; 28 Atl. 619; 23 L. R. A. 294; *Green v. Felton* (Ind.) 84 N. E. 166.

Cf. *Chicago Hansom Cab Co. v. Yerkes*, 141 Ill. 320, 321; 30 N. E. 667; 33 Am. St. Rep. 315; *Ritchie v. Vermillion Mining Co.*, 4 Ont. L. R. 588.

⁴ *Northwestern Transportation Co. v. Beatty*, 12 A. C. 589; *East Pant Du, etc. Co. v. Merryweather*, 2 Hem.

& Miller 254; *Bjorgaard v. Goodhue County Bank*, 49 Minn. 483; 52 N. W. 48; *Bill v. Western Union Tel. Co.*, 16 Fed. 14, 15 (semble); *Middleton v. Arastraville Mining Co.*, 146 Cal. 219, 224; 79 Pac. 889; *Blinn v. Riggs*, 110 Ill. App. 37; *United States Steel Corp. v. Hodge*, 64 N. J. Eq. 807, 813; 54 Atl. 1.

But see *Farmers' L. & T. Co. v. San Diego Street-Car Co.*, 45 Fed. 518, 527 (headnote inadequate).

⁵ *Pender v. Lushington*, 6 Ch. D. 70, 75-76; *Windmuller v. Standard Distilling, etc. Co.*, 115 Fed. 748 (where a shareholder voted in favor of winding-up in order to terminate a contract beneficial to the corporation but onerous for himself).

Cf. *Windmuller v. Standard Distilling, etc. Co.*, 114 Fed. 491.

§ 1304-§ 1311. *Relation of Majority of Shareholders to the Corporation and to the Minority.*

§ 1304. **Doctrine that Majority occupy no Fiduciary Relation to the Company or the Minority.** — Furthermore, inasmuch as no single member occupies a fiduciary position towards the company, therefore, upon the principle that zero plus zero must still be zero, a majority of the shareholders taken together, some authorities have held, must also stand in no fiduciary relation towards the corporation. Hence, these authorities hold that even where one person owns a majority of the shares in a corporation he may still contract with the company as freely as an entire outsider,¹ and may manage the corporation as he pleases although he may have larger individual interests antagonistic to the company.² Any contracts between himself and the company are not presumptively fraudulent; but fraud must be proved affirmatively.³ Hence, a minority shareholder has no right to require the owner of a majority of the shares to permit the former to participate in the profits of the latter realized upon a contract with the company.⁴ Thus, a corporation which owns a majority of shares in a rival company may compete with the latter and eventually drive it out of business, provided only a corrupt intention of deliberately mismanaging the subsidiary company so as to bring about its ruin be not proved.⁵

§ 1305. **Practical Objections to this Doctrine.** — As a practical matter, some of these conclusions of law as to the relation of the majority of the company are very unfortunate. For obviously, where one person, or group or confederacy of persons, owns a majority of the shares in a corporation, the minority are even more completely at his or their mercy than if the

¹ Cf. *Rothchild v. Memphis, etc. R. R. Co.*, 113 Fed. 476; 51 C. C. A. 310 (purchase of company's property at judicial sale); *Hanchett v. Blair*, 100 Fed. 817.

² *Windmüller v. Standard Dyeing, etc. Co.*, 114 Fed. 491.

³ *Wolf v. Pennsylvania R. R. Co.*, 195 Pa. St. 91; 45 Atl. 936; *United States Steel Corp. v. Hodge*, 64 N. J. Eq. 807; 54 Atl. 1 (with which com-

pare another New Jersey case cited infra, § 1306); *Colgate v. U. S. Leather Co.* (N. J.), 67 Atl. 657, 663-664; *Shaw v. Davis*, 78 Md. 308; 28 Atl. 619; 23 L. R. A. 294.

⁴ *Beardsley v. Beardsley*, 138 U. S. 262, 267-268; 11 Sup. Ct. 318 (semble).

⁵ *Cannon v. Brush Electric Co.*, 96 Md. 446, 474; 54 Atl. 121; 94 Am. St. Rep. 598.

company were unincorporated. For the members of a partnership have at least the privilege of dissolving the firm, while a shareholder in a corporation cannot relieve himself from membership unless he can find a purchaser for his shares. To be sure, not even the majority of a corporation can subject the other members to unlimited individual liability; whereas each partner has that very dangerous power. But to the extent of a shareholder's interest in the corporation he is quite as completely at the mercy of the majority as if the company were unincorporated. The minority are, therefore, in the anomalous and unfortunate situation of being wholly within the power of persons whom the law refuses to regard as their fiduciaries, and who may use their power unscrupulously, for their own individual advantage, without fear of being held to account, unless fraud can be affirmatively established.

§ 1306. **Authorities holding that Majority occupy a Fiduciary Position.** — Accordingly, a commendable tendency is now noticeable on the part of the courts to look with considerable suspicion on a contract between a person who owns a controlling interest in a corporation and the company which he denominates.¹ Indeed, some cases lay down the broad doctrine, which is certainly salutary in practice whether or not it be sound in theory, that when a number of shareholders combine to constitute themselves a majority of the company and to control its management, or where one person owns a majority of the shares, they or he occupy a fiduciary relation towards the minority,² and must

¹ *Central Trust Co. v. Bridges*, 57 Fed. 753; 6 C. C. A. 539; *Ervin v. Oregon, etc. Navigation Co.*, 27 Fed. 625; *Mumford v. Ecuador Development Co.*, 111 Fed. 639; *Pittsburg, etc. Ry. Co. v. Dodd*, 72 S. W. 822, 827-828; 24 Ky. Law Rep. 2057; 74 S. W. 1096; 115 Ky. 176; *Atwater v. Am. Exchange Bank*, 152 Ill. 605, 615-616; 38 N. E. 1017. ("A stockholder in making a contract of any kind with the corporation of which he is a member . . . is properly held to a larger measure of candor and good faith than if he were not a stockholder.")

Cf. Pearson v. Concord R. R. Corp.,

62 N. H. 537; 13 Am. St. Rep. 590.
² *Ervin v. Oregon Ry. & Navigation Co.*, 27 Fed. 625; *George v. Central R. R., etc. Co.*, 101 Ala. 607, 621-622; 14 So. 752 (majority stockholders not to vote when interested adversely to company); *Farmers' L. & T. Co. v. N. Y., etc. R. R. Co.*, 150 N. Y. 410, 430-431, 434; 44 N. E. 1043; 55 Am. St. Rep. 689; 34 L. R. A. 76; *Miner v. Belle Island Ice Co.*, 93 Mich. 97; 53 N. W. 218; 17 L. R. A. 412; *Crichton v. Webb Press Co.*, 36 So. 926; 113 La. 167; 104 Am. St. Rep. 500; 67 L. R. A. 76; *Glengary Consolidated Mining Co. v. Boehmer*, 62 Pac. 839; 28

affirmatively establish the *bona fides* of their, or his, dealings with the company.¹ These authorities refer only to the relation between the company (represented for this purpose by the minority shareholders) and the majority shareholders; and hence, dealings between a corporation and the holder of a majority of its shares are certainly not open to attack by a creditor of the company without proof of actual fraud.²

§ 1307. *Cases where one Class of Shareholders have no Voting Rights.* — Where one class of shareholders have no vote or voice in the corporate management, there is the stronger reason for holding that the other shareholders stand in fiduciary relation towards them.³

§ 1308. **Ownership of Majority of Shares as Link in Chain of Evidence to prove Fraud.** — Even in the ordinary case, and even according to the old view that majority shareholders are not fiduciaries, the law is not so blind to facts as to disregard altogether the circumstance that the person or group of persons against whom fraud is charged in corporate management were in control of the company, and had therefore an opportunity for wrongdoing. The fact that the corporation is wholly in the power of persons charged with fraud is to be considered along with other circumstances, and may sometimes lead the court to

Colo. 1; *Jones v. Missouri-Edison Electric Co.*, 144 Fed. 765, 771; 75 C. C. A. 631 (where it was said "The devolution of power imposes correlative duty"); *Reilly v. Oglebay*, 25 W. Va. 36 (majority enjoined from purchasing company's property); *Wheeler v. Abilene Nat. Bank*, 159 Fed. 391.

¹ *Meeker v. Winthrop Iron Co.*, 17 Fed. 48, 51 ("The burden of proof is upon the parties . . . claiming the enforcement of such contract"); *Booth v. Land Filling, etc. Co.* (N. J.), 59 Atl. 767.

Cf. *Russell v. Rock Run, etc. Gas Co.*, 184 Pa. St. 102, 108; 39 Atl. 21; *Montgomery Traction Co. v. Harmon*, 140 Ala. 505; 37 So. 371; *McLeod v. Lincoln Medical College*, 98 N. W. 672; 69 Nebr. 550.

See also *Chicago Hansom Cab Co. v. Yerkes*, 141 Ill. 320; 30 N. E. 667;

33 Am. St. Rep. 315 (apparently going so far as to hold that a sale of corporate property made by a holder of a majority of the shares on behalf of the company with himself is voidable by the minority even if *bona fides* be affirmatively proved); *Glen-gary Consolidated Mining Co. v. Boehmer*, 62 Pac. 839; 28 Colo. 1 (contract voidable by minority shareholder although actual good faith was unimpeached); *Robertson v. Bucklen & Co.*, 107 Ill. App. 369 (where the opinion contains passages not easy to reconcile with one another). Parts of the same question are considered below, § 1591.

² See *Hanchett v. Blair*, 100 Fed. 817; 41 C. C. A. 76.

³ *Mackintosh v. Flint, etc. R. R. Co.*, 34 Fed. 582, 613; *Kidd v. New Hampshire Traction Co.* (N. H.), 66 Atl. 127 (semble).

construe as fraudulent actions that might otherwise pass as innocent. But the court will indulge no suspicion merely because a majority of the company's shares were owned by the person accused of fraud, if the directorate is independent of his influence.¹ His ownership of a majority of the shares does not, it seems, justify the inference that the directors are under his control.²

§ 1309. **Construction of a Contract between Majority and the Company.** — Upon any view, a contract between a corporation and the owner of a majority of its shares, which is not impeached as either constructively or actually fraudulent, must be construed so as to confer the same rights and remedies upon the contracting parties as if they were strangers to one another. For instance, a contract of pledge between two corporations, one of which owns a controlling interest in the other, must be construed so as to confer upon the pledgee the same remedies by power of sale and otherwise as if the contracting parties had been strangers.³

§ 1310. **Assumption by Majority of Fiduciary Relation towards Minority.** — Of course the holders of a majority of the shares may voluntarily assume a fiduciary relation towards the minority. Thus, where the owner of substantially all the shares in a corporation agrees to convey a one-third interest in the company to his brother, the circumstances may be such as to show that the parties became joint adventurers in the enterprise, so that the owner of the smaller interest might require his brother to account for all profits made by means of contracts between the corporation and himself.⁴ So, where a large shareholder is appointed proxy for certain other shareholders and trustee for others, a resolution which gives him a large gratuity as bonus in recognition of alleged services to the company, and which is carried by his votes as such proxy and trustee, may be avoided by the corporation.⁵ Moreover, where three persons who together own all the shares in a company agree jointly to sell

¹ *Porter v. Pittsburg Bessemer Steel Co.*, 120 U. S. 649, 670 (headnote inadequate); 11 Sup. Ct. 318.
² *United Gold, etc. Co. v. Smith*, 44 N. Y. Misc. 567; 90 N. Y. Supp. 199.
³ See *supra*, § 1148.
⁴ *Ex parte Fisher*, 20 S. Car. 179.
⁵ *Beardsley v. Beardsley*, 138 U. S. 1084.

their interest in the company, one of them who stipulates with the purchaser for the payment of a secret bonus to himself may be required to account therefor to his joint adventurers or co-contractors.¹

§ 1311. **Corporation not Agent of Majority.** — The fact that one person or group of persons may own a majority of the capital of a corporation and may dictate its management certainly has no tendency to show that the corporation is a mere agent of the majority shareholders, so as to make the latter personally responsible for torts committed or misrepresentations made or contracts entered into by the officers of the company in the conduct of its business.² If the rule were otherwise, the protection of limited liability would be extended only to the minority shareholders.

§ 1312. **Relation of entire Body of Shareholders to the Corporation.** — The relation of the entire body of shareholders to the corporation involves the doctrine of the corporate fiction. The much abused corporate fiction is not a mere technicality, it is a principle which in most cases more nearly accomplishes perfect justice than could be done by regarding the shareholders for the time being as equivalent to the corporation.³ This is demonstrated by the tendency of business men and of some courts to regard a mere partnership as an entity apart from the several partners. The question how far the courts will disregard the corporate fiction usually arises in connection with so-called one-man companies, and is therefore considered in a former chapter.⁴ The principle, however, that in any case of fraud the courts will brush aside the corporate fiction and regard the shareholders as identical with the corporation is not limited to one-

¹ *Synnott v. Cumming*, 116 Fed. 40.

³ *Donnell v. Herring-Hall-Marvin*

² *National Bank of Commerce v. Allen*, 90 Fed. 545; 33 C. C. A. 169; *Co.*, 208 U. S. 267 (headnote inadequate).

Salomon v. Salomon & Co. (1897),

A. C. 22. Cf. *Dodd v. Pittsburg, etc. R. R. Co.* (Ky.), 106 S. W. 787. See also *supra*, § 1076.

⁴ *Supra*, Chapter XVII. See also *supra*, § 1290-§ 1294.

But see *Rieger, Kapner & Altmark*, 157 Fed. 609.

man companies but is of general application.¹ Except possibly in the case of one-man companies, it is submitted that a court should never disregard the corporate fiction unless the fiction is set up as a cover for fraud. It must be acknowledged, however, that some courts have not always deferred to this extent to the corporate fiction. For instance, in a recent case, a federal judge decided that where a number of persons who together held all the shares in a corporation united in a contract to sell their shares and also to execute a deed conveying to the purchaser the real estate owned by the corporation, the company in its corporate capacity was not a necessary party to a bill for specific performance.² But as a general rule the courts are agreed that the corporate fiction ought not to be disregarded except in case of fraud. Thus, the fact that two corporations are composed of the same shareholders does not make the contracts of one company binding upon the other.³

¹ See *supra*, § 344. Cf. *Rieger, Kapner & Altmark*, 157 Fed. 609. ³ *Waycross, etc. R. R. Co. v. Offerman, etc. R. R. Co.*, 109 Ga. 827

² *McCullough v. Sutherland*, 153 Fed. 418. (headnote inadequate); 35 S. E. 275.

CHAPTER XXIII

DIVIDENDS

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§ 1313-§ 1344. WHAT FUNDS ARE AVAILABLE FOR DIVIDENDS

§ 1313. **In general — Dividends not to be paid out of Capital but only out of Profits.** — The chief end of every legitimate business corporation is to earn profits and distribute them among its members, — in other words, the payment of dividends.¹ The capital of the company is the fund which every shareholder has a right to expect shall be employed in the acquisition of the profits, and to which alone creditors can look for payment; and, accord-

¹ As to the meaning of the word "dividend" in this connection, see *supra*, p. 495, n. 5, and § 602.

ingly, any expenditure of this capital for any other purpose whatsoever would infringe the rights of both shareholders and creditors. Hence, it is well established that to return any portion of the capital to the shareholders under the guise of dividends is both *ultra vires* and illegal.¹ This rule is a necessary deduction from the scheme of an incorporated company, and exists entirely apart from any explicit statutory declaration. It is generally expressed by saying that dividends must not be paid out of capital, but sometimes by what is supposed to be the converse proposition, that dividends may only be paid out of profits.² Some authorities have declared that the former form is more correct and have intimated that, while dividends can never be paid out of capital, yet no rule of law requires that they be paid only out of profits.³ It would certainly seem, however, that no funds are properly applicable to dividends except such as may in a just sense be called profits.⁴ The acceptance of this statement as correct by no means enables one to determine what moneys are profits available for this purpose. That problem is not merely intricate in its nature, but also involved in the obscurity always occasioned by conflicting decisions.

¹ In addition to cases cited on succeeding pages, see *Siegman v. Electric Vehicle Co.* (N. J.), 65 Atl. 910; *Alexandra Palace Co.*, 21 Ch. D. 149. In *Read v. Head*, 6 Allen (Mass.) 174, the court seems to have assumed that a corporation whose business was dealing in real estate might lawfully divide up proceeds of sale even to the exhaustion of its entire capital; but no point of this kind was argued, and unless some enabling statute existed, the existence of which is not disclosed by the report, such dividends cannot lawfully be paid according to the well nigh uniform tenor of the authorities both in England and America, and cannot, it is submitted, be allowed without doing violence to sound principle. See, however, *Harvard College v. Armory*, 9 Pick. (Mass.) 446; *Olsen v. Homestead Land Co.*, 87 Tex. 368; 28 S. W. 944; *Heard v. Eldredge*, 109 Mass. 258; 12 Am. Rep. 687; *Bald-*

win v. Miller & Lux (Cal.) 92 Pac. 1030 (criticised, *supra*, § 624 — provision in incorporation paper for paying dividends out of capital held valid notwithstanding a statute prohibiting the directors from paying dividends except out of profits or from returning capital to the shareholders, as the statute was construed to be a restriction on the powers of the directors merely, and not on the powers of the corporation at large).

² *Mobile, etc. R. R. Co. v. Tennessee*, 153 U. S. 486, 496, 497; 14 Sup. Ct. 968.

³ *Bond v. Barrow Haematite Steel Co.* (1902), 1 Ch. 353.

⁴ 1 Palmer's Company Prec., 9th ed., 734; *Eyster v. Centennial Board of Finance*, 94 U. S. 500, 504 ("The dividends declared by a corporation in business usually are, and, except under special circumstances, always should be, from profits."); *Verner v. General & Commercial, etc. Co.* (1894) 2 Ch. 239, 266 (per Lindley, L. J.).

§ 1314-§ 1337. *METHODS OF DETERMINING WHETHER MONEYS AVAILABLE FOR DIVIDENDS ARE IN HAND.*

§ 1314-§ 1319. *Single Account or Balance-Sheet Method — Deducting Amount of Liabilities and Nominal paid-up Capital from Value of Assets.*

§ 1314. **Legality of this Method.** — *Availability of Excess of assets over Liabilities and nominal Capital for Dividends.* — Any excess in the value of a company's assets over its liabilities and paid-up nominal or share capital, whether due to earnings or to an appreciation of property, may, it seems, be treated as profits available for dividends.¹ Thus, where a banking company sells its Brazilian branch for a sum largely exceeding the paid-up capital and all incidental expenses, such excess may be used for dividends.² In this way dividends may be shown to be payable, although no separate revenue account is kept, by means of a balance-sheet or "living account showing the true

¹ *Williams v. Western Union Tel. Co.*, 93 N. Y. 162; *Hubbard v. Weare*, 79 Iowa 678; 44 N. W. 915; *Roberts v. Roberts-Wicks Co.*, 184 N. Y. 257, 266; 77 N. E. 13; 112 Am. St. Rep. 607 (where the court said: "When the property of a corporation has accumulated in excess of its chartered capital, the excess may be regarded and dealt with as constituting a surplus of profits").

Cf. *Oliver's Estate*, 136 Pa. St. 43; 20 Atl. 527; 20 Am. St. Rep. 894; 9 L. R. A. 421 (where a thousandfold increase in value of the company's lands on account of the discovery of mineral deposits thereon was declared to be profits earned by the company); *Hite v. Hite*, 93 Ky. 257, 267; 20 S. W. 778; 40 Am. St. Rep. 189; 19 L. R. A. 173 (where the legality of declaring a dividend out of the amount realized from an increase in value of the company's real estate was apparently recognized, but where the dividend was held to be capital and not income as between a tenant for life of shares and a re-

mainderman); *Hemenway v. Hemenway*, 181 Mass. 406, 410-411; 63 N. E. 919 (where the court intimated a doubt whether money once devoted to permanent capital improvements could be liberated and distributed as dividends).

² *Lubbock v. British Bank of So. America* (1892), 2 Ch. 198. The opinion confuses fixed and circulating capital (see *infra*, § 1323); but, if the proposition laid down in the text is sound, the distinction would have been immaterial for the purposes of the case. However, in *Bolton v. Natal Land Co.* (1892), 2 Ch. 124, 133, it was said that an increase in the value of a company's real estate should not be treated as profits; but this opinion was expressed prior to the decision in the *Lubbock Case*, *supra*.

Cf. *Mackintosh v. Flint, etc. R. R. Co.*, 34 Fed. 582 (where it was held that moneys realized from a sale of a railway company's surplus lands were properly available for dividends).

financial position of the company at its date." The balance-sheet comprises all the company's assets including all earnings in hand; and from this sum the nominal paid-up capital and all the debts and liabilities may be deducted, the balance being the amount available for dividends. Where this system is adopted, a profit and loss account is usually kept, and the balance, whether to the debit or the credit of the profit and loss account, is carried over as an item in the balance-sheet. This method of determining, by means of a balance-sheet, whether dividends are payable is often misleading, and is sometimes likely to encourage fraudulent overvaluation of the assets, but nevertheless, as already stated, it is not, if honestly carried out, illegal. Indeed, an experienced author contends with great ability that this system is the only proper system.¹

§ 1315. **Necessity for including in Reckoning all Transactions down to Time of striking Balance.**— In order that this method of ascertaining the amount, if any, available for dividends may be lawful, all the transactions of the company down to the very time of striking the balance must be brought into the reckoning. Thus, where a large sum was unexpectedly realized from an asset previously regarded as worthless, the company was enjoined, temporarily, from distributing the same among the shareholders until some accounting should be had of the company's other assets and of the current year's operations;² but the court conceded that unless this fund should be off-set by losses of that year or by depreciation of other assets, it might after a full accounting be distributed as dividends.

§ 1316. **What Items must be deducted as Liabilities.**— Of course, in making up the balance-sheet, all outstanding liabilities must be deducted from the value of the assets. Thus, dividends are illegally paid where an insurance company makes no allowance for outstanding risks.³ Moreover, money borrowed with the understanding that it should be repaid out of the first surplus earnings must be treated as a liability and not as an asset.⁴

¹ 1 Palmer's Company Precedents, Co., 6 Paige (N. Y.) 486, 488 9th ed., pp. 734 et seq. (semble).

² Foster v. New Trinidad Lake Cf. Lexington, etc. Ins. Co. v. Asphalt Co. (1901), 1 Ch. 208. Page, 17 B. Monr. (Ky.) 412; 66

³ Rance's Case, L. R. 6 Ch. 104; Am. Dec. 165.

DePeyster v. American Fire Ins. ⁴ Russell v. Bristol, 49 Conn. 251, 273.

§ 1317. **Necessity for deducting nominal paid-up Capital.** — For purpose of ascertaining by means of a balance-sheet whether a dividend may be declared, the nominal paid-up capital must be treated as a liability and deducted from the value of the assets.¹ It seems that if shares have been forfeited they are still for this purpose to be regarded as outstanding.²

§ 1318. **Necessity for valuing the Assets fairly — Judgment of Directors.** — The valuation of the company's assets must not be excessive, or the dividends will be improperly paid.³ Most of the cases upon this subject have been attempts to hold the directors personally responsible for dividends paid upon the basis of such overvaluation; and the courts have exhibited a tendency to defer to their judgment and to relieve them from liability unless the overvaluation was manifest⁴ — a tendency which would doubtless not be displayed if the question were raised by a shareholder seeking to prevent by injunction the payment of the dividend. In *Stringer's Case*,⁵ directors were exonerated from liability for paying dividends upon a balance-sheet which in May, 1864, estimated certain obligations of the Confederate Government at their par value. But where the balance-sheet shows a surplus by treating as valuable assets which are clearly worthless, the payment of the dividends is certainly illegal and the directors are liable for making the payment.⁶

§ 1319. **What may be treated as Assets.** — Lord Hatherley once said that goodwill cannot be treated as an asset in a balance-sheet of this sort,⁷ because the value of the goodwill appears in the earnings of the company and should not be counted twice; but it is difficult to perceive any real difference in that respect between goodwill and any other productive asset, and accordingly it is submitted that Lord Hatherley's dictum is

¹ That the capital is not in any proper sense a liability of the corporation but in these cases is to be treated as such merely for convenience in bookkeeping, see *supra*, § 507.

² *Gratz v. Redd*, 4 B. Monr. (Ky.) 178, 187.

³ *Am. Steel & Wire Co. v. Eddy*, 101 N. W. 578; 138 Mich. 403.

⁴ See cases cited in two succeed-

ing notes, and also *Tradesman Pub. Co. v. Car Wheel Co.*, 95 Tenn. 634; 32 S. W. 1097; 31 L. R. A. 593; 49 Am. St. Rep. 943. Cf. *infra*, § 1523, § 1533 et seq.

⁵ *Stringer's Case*, 4 Ch. 475.

⁶ *Flitcroft's Case*, 21 Ch. D. 519; *Leeds Estate Bldg., etc. Co. v. Shepherd*, 36 Ch. D. 787.

⁷ *Turquand v. Marshall*, 4 Ch. 376, 384.

at least doubtful law.¹ It has even been held that where a large amount has been expended for advertising at an international exposition, a part of the amount so expended may fairly be treated as an asset of the company,² presumably upon the theory that a return of at least that amount may reasonably be expected from the expenditure; but certainly a rule which permits of such speculation is not conducive to conservatism in corporate management.³

§ 1320-§ 1337. DOUBLE ACCOUNT METHOD — DISTINCTION BETWEEN CAPITAL ACCOUNT AND REVENUE ACCOUNT.

§ 1320. *In general.* — We have seen that no separate revenue account is a necessary preliminary to the declaration of dividends, but that a complete valuation may be made at any given time of all the company's assets — capital and accrued earnings — the excess of which over the liabilities and nominal paid-up capital is distributable as dividends. Another method of bookkeeping, however, distinguishes between capital and revenue, two separate accounts being kept. The revenue account shows merely current expenditures and receipts, disregarding all appreciation or depreciation of capital. The excess of one over the other is loss or profit as the case may be.⁴ If the theory of the double account be carried out, profits available for dividends should be estimated without regard to the capital account, or to any loss of capital or increment to capital which may appear from that account.⁵ We have already seen, however, that any increase or appreciation of capital over and above the legal or nominal amount may in the discretion of the company be treated as profits distributable among the shareholders;⁶ and it follows that where the two-account sys-

¹ Cf. *Murray v. Bush*, L. R. 6 H. L. 37, 57-58, per Lord Cairns.

² *Davenport v. Lines*, 77 Conn. 473; 59 Atl. 603.

³ Cf. *Hubbard v. Weare*, 79 Iowa 678; 44 N. W. 915 (where a good discussion will be found of the question what may be reckoned as assets of the company).

⁴ *London & General Bank*, 72 L. T. 227.

⁵ Cf. *Phillips v. Melbourne, etc. Candle Co.*, 16 Vict. L. R. 111, 114, where the court said: "The proper fund for the payment of dividends is the excess of a company's earnings over the expenses incurred in obtaining them. Such excess constitutes the profits out of which dividends may be paid."

⁶ *Supra*, § 1314.

tem is used, any such increment to the value of capital may be carried over to the revenue account. Evidently, any balance against the company on the revenue account is a debt of the corporation, and must be made up out of capital.

§ 1321-§ 1329. *Whether Loss or Deficiency on Capital Account must be made good out of Profits shown on Revenue Account before Dividends can be paid.*

§ 1321. **Analysis.** — The question whether a loss or depreciation on capital account must be made good out of any balance in favor of the company on the revenue account before any dividends can be paid the shareholders is very difficult of solution. The answer may depend (1) on the nature of the capital lost or depreciated, (2) on the nature of the loss or depreciation, or (3) on the time or the loss.

§ 1322. **Whether Over-capitalization must be wiped out with Balance on the Revenue account before paying Dividends.** — It should be premised that the circumstance that the original value of the company's assets did not equal its nominal paid-up capital does not oblige the corporation to accumulate its earnings until the over-capitalization is wiped out, before paying dividends.¹ Thus, where under a valid agreement, shares are issued as full-paid in exchange for property, the circumstance that the property is taken at an overvaluation, so that the total assets do not equal the nominal capital, does not prevent the declaration of dividends out of current profits without waiting to get rid of the "water."² If the shares were issued in return for services rendered, or supposed to have been rendered, to the company, strong reasons could be assigned for reaching a different

¹ *Goodnow v. Am. Writing Paper Co.* (N. J.), 66 Atl. 607. Cf. *Washburn National Wall-Paper Co.*, 81 Fed. 17; 26 C. C. A. 312.

But see *Williams v. Western U. Tel. Co.*, 93 N. Y. 162.

² *Lee v. Neuchatel Asphalte Co.*, 41 Ch. D. 1, 15, 26; *Wilmer v. McNamara, etc. Co.* (1895), 2 Ch. 245, 252; *Goodnow v. Am. Writing Paper*

Co. (N. J.), 66 Atl. 607 (where the agreement to accept the property in full payment for the shares was good as against all the shareholders, although open to attack by creditors, and where the objection to payment of the dividend was raised by a shareholder).

Cf. *Bolton v. Natal Land Co.* (1892), 2 Ch. 124.

result; for while property may be purchased out of capital, services rendered are generally chargeable to revenue or income; but more probably than not the courts would assimilate the two cases.

§ 1323. **Distinction between Fixed and Circulating Capital.** — Capital was divided by Adam Smith into two kinds — fixed and circulating.¹ Fixed capital is capital from which the owner makes a profit by retaining it in his possession, such as a merchant's warehouse or store, a mining company's mine, a manufacturing company's plant, or a railway's roadbed or rolling stock. Circulating capital, on the other hand, is that form of capital from which the owner makes a profit by selling it, or otherwise parting with the possession of it — for example, a merchant's stock in trade, or a mining company's minerals when severed from the freehold, or a factory's manufactured products. Some industries, such for instance as a railway, require little or no circulating capital. This distinction between fixed and circulating capital has been thought material in some of the cases on dividends, and therefore cannot be neglected, although its bearing in point of law upon the present subject may well be doubted, and has indeed been questioned by experienced lawyers and text-writers.²

§ 1324. **Ways in which either kind of Capital may be Lost.** — Capital, of either sort, may be lost or diminished in value in a variety of ways. For instance, it may perish in some sudden calamity — a fire, a flood, or a shipwreck. Or, it may deteriorate through wear and tear, or through the simple efflux of time. Or, the company's property may be depreciated by depression in the market. Again, debts due to the company may prove worthless. Lastly, the expenditures on revenue account may exceed the receipts. Capital lost in this last way can only be circulating capital, but in all the other cases the capital lost may be either fixed or circulating.

§ 1325. **Of the rule that Losses of Fixed Capital need not be made good out of Revenue before paying Dividends** — *In general.* — The English Courts (other than the House of Lords) have held that in estimating the profits available for dividends losses of fixed capital, or depreciation in its value, in whatever way

¹ Smith's *Wealth of Nations*, Book II, Ch. 1.

² See 1 Palmer's *Company Precedents*, 9th ed., 734-762.

occurring, may, so far as the bare legal power of the corporation is concerned, be disregarded;¹ and the same rule has been recognized in America.²

§ 1326. *Loss through Depreciation of Assets of the Corporation.* — A company is not precluded from paying dividends out of the excess of current receipts over expenditures because the securities in which its capital is invested have depreciated.³ In the case just cited, the company was an “investment company” — that is to say, it anticipated profit from the income received from its invested funds, so that its securities were fixed as distinguished from circulating capital. The English Court of Appeal very clearly laid down the proposition that where the revenue account shows a balance in favor of the company dividends may legally be paid although a contemporaneous loss of fixed capital has occurred; but, they declared, a loss of circulating capital must be charged against the revenue account, so that if, in the case before them, the corporation had been a stock-jobbing company, whose securities are circulating capital, the proposed dividend would have been illegal. In *Bolton v. Natal Colonization Co.*,⁴ the company was formed for the purpose of dealing in real estate, and it was held that a loss due to the depreciation of its lands need not be charged against the revenue account; but there the property seems to have been circulating capital, so the decision ignores the distinction subsequently taken in the *Verner Case*.⁵ Goodwill is fixed capital,

¹ *Infra*, § 1326, § 1327. Cf. *Phillips v. Melbourne, etc. Candle Co.*, 16 Vict. L. R. 111.

² *Excelsior Water Co. v. Pierce*, 90 Cal. 131; 27 Pac. 44. *A fortiori*, a dividend is not illegal because the company's assets do not equal its indebtedness plus its capital stock. *Miller v. Bradish*, 69 Iowa 278; 28 N. W. 594.

It is believed, however, that the statutes of some states require losses of fixed capital to be made up out of profits before dividends become payable. Cf. *Cotting v. New York, etc. R. R. Co.*, 54 Conn. 156; 5 Atl. 851 (where a special statute authorizing the issue of preferred shares was held to authorize the payment of the

preferential dividend out of future earnings without making good a prior loss or impairment of capital notwithstanding a general statute forbidding the payment of dividends by corporations whose capital is impaired).

As to what evidence is indispensable to prove diminution in value of the company's assets, see *Washburn v. National Wall-Paper Co.*, 81 Fed. 17; 26 C. C. A. 312.

³ *Verner v. General & Commercial Trust* (1894), 2 Ch. 239.

⁴ *Bolton v. Natal Land Colonization Co.* (1892), 2 Ch. 124.

⁵ *Verner v. General & Com. Investment Trust* (1894), 2 Ch. 239.

and, therefore, in accordance with the *Verner Case*, dividends may be paid out of current profits disregarding a depreciation in the goodwill of the company's business.¹ The same is true where the loss of fixed capital was due to the decrease in value of "wasting assets"² such as a lease,³ or a mining right.⁴ So a loss of fixed capital occasioned by some sudden calamity may be disregarded — for example, a loss occasioned to a mining company by an injunction against hydraulic mining.⁵

§ 1327. *Loss from Wear and Tear — Whether necessary to lay by a Repair Fund out of the Revenue.* — Large portions of the fixed capital of many corporations consist in assets which deteriorate through user. Of this character are the ships of a shipping company, or the roadbed or rolling stock of a railway. Good business policy undoubtedly demands that a sum be set aside each year to counterbalance such depreciation.⁶ Nevertheless such deterioration is merely a loss of fixed capital; and, if the principles stated in the last two sections be sound, no rule of law requires such action.⁷

¹ *Wilmer v. McNamara & Co.* (1895), 2 Ch. 245.

² Cf. *Bagot Pneumatic Tyre Co. v. Clipper Pneumatic Tyre Co.* (1902), 1 Ch. 146 (license to use a patent).

³ *Wilmer v. McNamara & Co.* (1895), 2 Ch. 245.

⁴ *Lee v. Neuchatel Asphalte Co.*, 41 Ch. D. 1 (semble); *Lambert v. Neuchatel Asphalte Co.*, 51 L. J. Ch. 882; *Excelsior, etc. Co. v. Pierce*, 90 Cal. 131; 27 Pac. 44 ("It may distribute its net earnings, although the value of its mine is thereby diminished. But it may not sell the mine or any part of it and distribute the proceeds."); *Second Universalist Church v. Colgrove*, 74 Conn. 79, 83; 49 Atl. 902 (semble).

Cf. *Coltness Iron Co. v. Black*, 6 A. C. 315; *Alianza Co. v. Bell* (1906), A. C. 18. But, it seems, each case must be decided on its own facts, and that if a company should purchase out of its capital the last two or three years of a valuable patent, a different result would be reached. *Bond v. Barrow Haematite Steel Co.* (1902), 1 Ch. 353, 367.

⁵ *Excelsior, etc. Co. v. Pierce*, 90 Cal. 131, 145; 27 Pac. 44.

⁶ "I should think that no commercial man would doubt that this is the right course — that he must not calculate net profits until he has provided for all the ordinary wear and tear occasioned by his business. In many businesses, there is a regular sum or proportion of some kind set aside for this purpose. Ship-owners, I believe, generally reckon for depreciation of a ship as it gets older. Experience tells them how much they ought to set aside, and whether the ship is repaired in one year or another makes no difference, because they know a certain sum must be set aside each year to meet the extra repairs of the ship as it gets older." Per Jessel, M. R., in *Davison v. Gillies*, 16 Ch. D. 347 n.

⁷ Cf. *Mackintosh v. Flint, etc. R. R. Co.*, 34 Fed. 582; *Eyster v. Centennial Board of Finance*, 94 U. S. 500, 503 (where Waite, C. J., said: "The public when referring to the profits of the business of a merchant, rarely ever take into account the

This, it is believed, is the result of two at first sight conflicting decisions of Sir George Jessel with reference to the London Tramways Company. The recorded by-laws, or articles of association, of that company provided that before declaring a dividend on the ordinary shares, the directors should set aside a fund for repairs and renewals of the company's railway. The preference shares carried a dividend of six per cent per annum "dependent upon the profits of that particular year only." For many years, dividends had been paid without observing the requirement of a repair fund. Sir George Jessel held that no further dividends on the ordinary shares could be paid until a sufficient repair fund should have been accumulated,¹ but that the preferred shareholders were, under the terms of the resolution creating their shares, entitled to a dividend at once.² So far as the ordinary shareholders are concerned, the decision was evidently controlled by the express terms of the above-mentioned by-law or article, and involves no proposition of general law.³ But the decision as to the preferred shares necessarily includes a decision that a payment of dividends by a railway company without laying by a repair fund is not *ultra vires*, or illegal, or a payment out of the capital.⁴ The case, therefore, accords with the general rule that a loss or depreciation of fixed capital need not be charged up against revenue.

So, in a voluntary liquidation of a solvent company, it was once held that a repair fund representing accumulated earnings should not be used in making good a loss of capital occasioned by a bad debt, but should be treated as profits to be used in

depreciation of the buildings in which the business is carried on, notwithstanding they may have been erected out of the capital invested").

But see *Whittaker v. Amwell Nat. Bank*, 52 N. J. Eq. 400, 404; 29 Atl. 203; *Excelsior, etc. Co. v. Pierce*, 90 Cal. 131, 141; 27 Pac. 44 (where the court said, "We do not think it would be necessary to pay, in the first place, the whole of such debts, but it would be necessary to pay accruing interest, and to provide a sinking fund sufficient to extinguish

the principal before the mine was exhausted").

¹ *Davison v. Gillies*, 16 Ch. D. 347 n.

² *Dent v. London Tramways Co.*, 16 Ch. D. 344.

³ See the observations upon the case in *Lee v. Neuchatel Asphalte Co.*, 41 Ch. D. 1, 18.

⁴ But see explanation of the case given by Harlan, J., in *New York, etc. R. R. Co. v. Nickals*, 119 U. S. 296, 309-310; 7 Sup. Ct. 209.

making up the arrears of dividends due upon the cumulative preferred shares.¹

But whether or not ordinary repairs to keep the company's equipment up to its original condition must be borne by the income account before any earnings can be used for dividends, it is clear that the expense of any permanent betterments or improvements may be borne by capital account and not charged to the revenue account.²

§ 1328. **Whether Loss of Circulating Capital must be made good out of Revenue.** — In *Re National Bank of Wales*,³ the English Court of Appeal apparently held that at the end of any fiscal year, losses even of circulating capital — in that particular case, debts due to the bank — might be written off and charged to capital; and that, if in the next year current receipts should exceed the expenditures, the excess might be devoted to dividends without making up the loss of capital. The House of Lords affirmed the judgment, but upon different grounds;⁴ and expressed serious doubt not merely as to the proposition laid down by the Court of Appeal, but even as to the doctrine that losses of fixed capital might be disregarded. Certainly the position of the lower court is somewhat startling;⁵ for, if losses of circulating capital, or an excess of current expenditures over receipts, may be written off at the end of the year and a fresh start made, may not the same thing legally be done at the end of a month or a week? Nevertheless, according to the theory of calculating profits by means of a revenue account, separate from the capital account, the conclusion that any such periodic rests are permissible would seem to be difficult to avoid,⁶ except in-

¹ *Bishop v. Smyrna, etc. Ry.* (1895), 2 Ch. 265. But see *supra*, § 567.

² *Mackintosh v. Flint, etc. R. R. Co.*, 34 Fed. 582.

But see *New York, etc. R. R. Co. v. Nickals*, 119 U.S. 296; 7 Sup. Ct. 209.

³ *National Bank of Wales* (1899), 2 Ch. 629.

⁴ *S. C. sub nom. Dovey v. Corey* (1901), A. C. 477, 487, 491.

⁵ See *Crichton's Oil Co.* (1902), 2 Ch. 86, 98, 99 (per Stirling, L. J.); 111. *Towers v. African Tug Co.* (1904), 1 Ch. 558.

⁶ *Hoare & Co.* (1904), 2 Ch. 208, 216, where Vaughan Williams, L. J., said, "However much capital you may have lost at any given date, if your profit and loss account shows a profit balance, then to the extent of that profit balance you are entitled to distribute that money as dividend notwithstanding the fact that you have lost capital which you have not replaced." See also *Phillips v. Melbourne, etc. Candle Co.*, 16 Vict. L. R.

deed that any action of the company on the subject must be reasonable and not a mere attempt to evade the rule against paying dividends out of capital. The relevancy of the distinction between fixed and circulating capital is a little difficult to see. At any rate, the doubts intimated by the House of Lords are almost revolutionary. A recent elaborate *dictum* of an English judge serves only further to complicate the matter.¹

§ 1329. **Doctrine that in each Case the Question is whether a Bona Fide Discretion has been Exercised.** — While it is doubtless true, as declared by the House of Lords in *Dovey v. Corey*² and by the Chancery Division in *Bond v. Barrow Haematite Steel Co.*,³ that the whole matter is one of good business sense and largely dependent upon the circumstances of each particular case, yet the courts must have some rules for their action, — there must be some permissible method or methods of ascertaining profits available for dividends, and other methods which are not permissible. It is therefore hardly safe to say that in each case the only question is whether in declaring a dividend the company is exercising a *bona fide* discretion and is not attempting to evade the rule against paying dividends out of capital.

§ 1330–§ 1337. *What Items belong in Capital Account, and what in Revenue Account.*

§ 1330. **Preliminary Statement.** — Taking as settled law, or assuming, that dividends may be paid where the current revenue account shows a profit balance irrespective of the state of the capital account, we must next inquire what items belong in the capital account, and what in the revenue account.

§ 1331. **Capital and Revenue Charges in general.** — *Recouping Revenue Account for Capital Charges borne by Revenue and Vice Versa.* — It is very difficult to say what expenses may properly be charged to capital account. To carry the working expenses of the year or the wages of employees to capital account “in order to make things look pleasant” would be “grossly ex-

¹ *Bond v. Barrow Haematite Steel Co.* (1902), 1 Ch. 353, where the unmined ore of a smelting company was thought to be circulating capital within the meaning of the rule.

² *Dovey v. Corey* (1901), A. C. 477.

³ *Bond v. Haematite Steel Co.* (1902), 1 Ch. 353.

travagant or fraudulent.”¹ Lord Hatherley once held, rather diffidently, that a railway company might charge the expenses of purchasing locomotives to capital account.² An assessment upon shares held in another company is properly chargeable to capital.³

Undoubtedly if capital charges have been borne by revenue, the revenue account may be recouped out of the capital account:⁴ it is upon this principle that the borrowing of money to pay dividends is sometimes lawful. Whether revenue charges borne by capital must be recouped out of subsequent revenue accounts is substantially the question involved in the *National Bank of Wales Case*.⁵

§ 1332. **Capital consumed in producing Earnings.** — Capital consumed in producing the earnings must certainly be charged against the revenue account. Such capital is always circulating capital. For instance, the earnings of a gas company cannot be ascertained without first deducting from the gross receipts the amount expended for raw materials, such as coal and oil, which are converted into gas.⁶ Whether such charges incurred in one year or dividend period must be charged against the revenue earned in subsequent years or periods is a question which has been considered above.⁷

§ 1333. **The Company's Indebtedness, Floating and Funded, and Interest thereon.** — Where a corporation borrows money for the construction of its works or for any other purpose, interest on the debt may, and indeed must be paid out of the capital if

¹ *Mills v. Northern Ry., etc. Co.*, 5 Ch. 621, 630-631 (semble).

² *Mills v. Northern Ry., etc. Co.*, 5 Ch. 621, 631. Said the learned judge: “I do not know exactly on what principle railway companies proceed in their accounts with respect to their locomotives, whether the whole value should be credited, or whether a deduction should be made annually for the stock wearing out, or whether the value of the stock should be taken, which would be the more regular course, at the end of every year. But certainly the new rolling stock is in a sense capital as long as it lasts, and that its value on each succeeding stock-taking is capital, there is no doubt whatever.”

Cf. *Corry v. Londonderry, etc. Ry. Co.*, 29 Beav. 263 (stated *infra*, p. 1104, n. 4).

³ *Excelsior, etc. Co. v. Pierce*, 90 Cal. 131; 27 Pac. 44.

⁴ *Mills v. Northern Ry., etc. Co.*, 5 Ch. 621.

Cf. *Mackintosh v. Flint, etc. R. R. Co.*, 34 Fed. 582, 609; *State v. B. & O. R. R. Co.*, 6 Gill (Md.) 363, 384.

⁵ *Supra*, § 1328.

⁶ *People ex rel. Brooklyn Gas Co. v. Morgan*, 114 N. Y. App. Div. 266 (as to the ascertainment of the “gross earnings” for purposes of taxation).

⁷ *Supra*, § 1328.

no other funds are available for the purpose.¹ As between the capital account and the revenue account, it has been held that such a charge should be borne by revenue, and that no dividend will be payable unless such interest has been added to the debit side of the revenue account;² but on the other hand, a late case tends to hold that where money is borrowed for the purpose of constructing permanent improvements, interest on the indebtedness may be charged to capital so as to permit the payment of dividends during the period of construction.³ Generally, the floating or current indebtedness of each year should be paid outright out of revenue,⁴ but in some cases a floating indebtedness may be funded and only the interest charged to revenue.⁵ Of course, the funded debt, such as the bonds or debentures issued by the company, need not be paid off before dividends can be paid to the shareholders.⁶ Where receipts of a given year are insufficient to pay the interest on the corporation's indebtedness, so that the same has to be paid out of capital, it has been held that the amount of capital so consumed does not have to be made good out of the profits of a subsequent year before dividends can be paid;⁷ but this decision can be supported only upon the doctrine questioned by the House of Lords in *Dovey v. Corey*⁸ that revenue charges borne by capital need not be made good before paying dividends in a succeeding fiscal year. It has been said that in addition to paying interest on its funded debt, a corporation must lay by a reasonable sum out of revenue as a sinking fund for discharging the debt at maturity.⁹

¹ *Van Dyck v. McQuade*, 86 N. Y. 38, 44. within the class of floating or current indebtedness).

² *Excelsior, etc. Co. v. Pierce*, 90 Cal. 131, 141; 27 Pac. 44 (semble); *Gratz v. Redd*, 4 B. Monr. (Ky.) 178, 188; *Mobile, etc. R. R. Co. v. Tennessee*, 153 U. S. 486, 498; 14 Sup. Ct. 968; *Bloxam v. Metropolitan Ry. Co.*, L. R. 3 Ch. 337 (per Wood, V. C., Lord Chelmsford on appeal dubitante). Cf. *Excelsior, etc. Mining Co. v. Pierce*, 90 Cal. 131; 27 Pac. 44; *Mobile, etc. R. R. Co. v. Tennessee*, 153 U. S. 486, 497; 14 Sup. Ct. 968.

⁵ *Belfast, etc. R. R. Co. v. Belfast*, 77 Me. 445, 452; 1 Atl. 362. ⁶ *Mills v. Northern Ry. Co.*, 5 Ch. 621, 631.

⁷ *Bosanquet v. St. John D'el Rey Mining Co.*, 77 L. T. 206. ⁸ *Dovey v. Corey* (1901), A. C. 477. See supra, § 1328.

⁴ *Corry v. Londonderry, etc. Ry. Co.*, 29 Beav. 263 (holding that debts of a railway company "incurred for steam-engines, rails, completing stations, and the like" fall *Excelsior, etc. Co. v. Pierce*, 90 Cal. 131, 141; 27 Pac. 44.

But see *Hazeltine v. Belfast, etc. Railroad Co.*, 79 Me. 411. 421; 10

§ 1334. **Premiums realized on Issue of Bonds or Shares.** — Where a company issues bonds at a premium, the premium is secured in part by the attractive rate of interest which the bonds are to bear; and, as the interest must be paid out of income, a federal judge has held that the amount of the premium is quite properly distributable as dividends.¹ It would seem also that where shares are issued at a premium, the amount of the premium may be treated as profit.²

§ 1335. **Moneys due the Company but not actually paid.** — It has been held that, in stating a revenue account, interest on money lent by the company, which although abundantly secured has not been actually paid to the company, cannot be included among the current receipts.³ This decision must rest upon the proposition that only cash actually in hand can be treated as a receipt. But although a rule of this strictness is undoubtedly beneficial in preventing over-sanguine estimates, yet it may well be doubted whether the rule can be supported on principle. For instance, who would doubt that money deposited in bank to the credit of the company may be treated as a receipt?

§ 1336. **Premiums paid an Insurance Company for outstanding Risks.** — An insurance company cannot, it has been held, treat as profit all premiums received, without making any allowance for probable losses on the risks assumed in consideration thereof.⁴

§ 1337. **Whether accumulated Profits may be carried to the Revenue Account without Deduction for Losses sustained in the Meantime and charged to Capital.** — Where a corporation accumulates its profits as a surplus or reserved fund, the determination to refrain from using the accumulated fund for dividends may be revoked at any time. If, however, in the meanwhile, losses have been sustained, the question arises whether

Atl. 328; 1 Am. St. Rep. 330; *Carpenter v. N. Y. & N. H. R. R. Co.*, 5 Abb. Pr. 277, 280 (the indebtedness was disputed by the company).

Cf. *Gratz v. Redd*, 4 B. Monr. (Ky.) 178, 188.

¹ *Mackintosh v. Flint, etc. R. R. Co.*, 34 Fed. 582, 606.

² Cf. *Hoare & Co.* (1904), 2 Ch. 208. See also *supra*, § 522, § 602.

³ *People ex rel. Farnum v. San Francisco Savings Union*, 72 Cal. 199; 13 Pac. 498 (where by statute dividends were payable only out of "surplus profits").

⁴ *Lexington, etc. Ins. Co. v. Page*, 17 B. Monr. (Ky.) 412; 66 Am. Dec. 165.

the reserved fund may nevertheless be carried over to the revenue account without deduction for the losses and distributed as dividends, or whether the whole, or if not the whole some proportion, of the losses must be borne by the surplus or reserve fund to the complete or partial exoneration of the capital. Where a trading company had accumulated profits as a reserve fund which was mingled indistinguishably with the company's capital moneys and used in its business, it was held that a subsequent loss in trading might be apportioned fairly between the capital and the reserve fund, and that the whole of the loss need not be borne by the reserve fund.¹ It would seem to follow from this decision that all the rest of the reserve fund might then be distributed as dividends.²

§ 1338-§ 1340. *Evasions of Rule against paying Dividends out of Capital.*

§ 1338. **Guarantee of Dividends by Person Dealing with the Company.** — The rule that dividends must not be paid out of capital of course cannot be got around by any mere evasion. Thus, where in consideration of a cash payment to be made out of a company's capital, a contractor agrees to perform certain services for the company and also to pay a seven per cent dividend to its shareholders, the execution of the agreement would be an indirect payment of the dividend by the company out of its capital; and therefore the agreement is illegal and void.³ A later case in the English Court of Appeal⁴ seems, however, in conflict with the decision of the House of Lords in *James v. Eve*. In Connecticut, moreover, an agreement by the lessee of a railway company to pay a fixed annual dividend to the preferred

¹ *Hoare & Co.* (1904), 2 Ch. 208.

² Note that Vaughan Williams, L. J., was of opinion that the whole of the reserved moneys might be distributed as dividends as if no loss had occurred: (1904), 2 Ch. 217.

³ *James v. Eve*, L. R. 6 H. L. 335, 344, 350. Cf. *Smith v. Alabama Fruit Growing, etc. Ass'n*, 123 Ala. 538; 26 So. 232 (where a bond executed by the corporation as principal

and certain individuals as sureties conditioned for the payment of a certain dividend was held unenforceable).

But see *Tod v. Kentucky Union Land Co.*, 57 Fed. 47; 6 C. C. A. 685; *Crook v. Scott*, 65 N. Y. App. Div. 139; 72 N. Y. Supp. 516, affirmed short, 174 N. Y. 520; 66 N. E. 1106.

⁴ *Ex parte Jegon*, 12 Ch. D. 503.

shareholders has been held to be valid; ¹ but the objection which we are now considering does not appear to have been taken. Of course, an agreement to pay, not to the shareholders, but to the company, a sum equal to the difference between the amount of profits earned by the company and such amount as would pay a dividend of seven per cent on its shares is free from all objection on this score, since the moneys so paid belong to the general funds of the company, so that no payment of dividends out of capital can result.² Moreover, an agreement between shareholders or promoters, to which the company is not a party, and by which some of the parties guarantee to the others a certain dividend on their shares would appear to be unobjectionable.³

§ 1339. **Guarantee of Dividends by Corporation itself.** — Of course, a guarantee of dividends by the corporation itself, if the word "guarantee" were used in its ordinary or natural sense, would be still more clearly equivalent to an agreement to pay dividends out of capital and would therefore be illegal and void.⁴ Such a "guarantee" is, however, saved from the taint of illegality by a rule of construction; for if possible the courts will construe the guarantee not as meaning that dividends are to be paid even though sufficient profits be not earned, but merely as giving a preference over the other shares in respect to any funds properly available for dividends.⁵

§ 1340. **Payment of Interest on unproductive Capital — Interest on Capital paid up in Advance of Calls.** — Manifestly, "interest" on capital not yet productive — such, for example, as capital employed in constructing a railway not yet completed for traffic — cannot under any circumstances be paid to the shareholders out of capital: dividends cannot be paid out of capital

¹ *Middletown v. Boston, etc. R. R.* 758; *South Yorkshire Ry. Co. v. Co.*, 53 Conn. 351; 5 Atl. 706. *Great Northern Ry. Co.*, 9 Ex. 55.

But see *Phillips v. Eastern R. R. Co.*, 138 Mass. 122, 135-138.

² Cf. *Re Stuart's Trusts*, 4 Ch. D. 213; *Beveridge v. New York Elevated R. R. Co.*, 112 N. Y. 1; 19 N. E. 489; 2 L. R. A. 648 (holding that the individual shareholders cannot sue to enforce such a guaranty made to the corporation); *Goodwin v. Hardy*, 57 Me. 143; 99 Am. Dec.

³ Cf. *Lorillard v. Clyde*, 86 N. Y. 384; *Columbus Trust Co. v. Mosher*, 100 N. Y. Supp. 1066; 51 N. Y. Misc. 270 (holding that the guarantee is subject to an implied condition that the corporation continue to exist, and is terminated by its dissolution).

⁴ See *supra*, § 543.

⁵ See *supra*, § 542.

simply by calling them interest.¹ But the House of Lords has held that where money has been paid in by a shareholder in advance of calls, he becomes a creditor of the company, which may, therefore, pay him interest on the debt even if the payment has to be made out of capital;² but the decision turned on the fact that such payment of interest was expressly sanctioned by the Companies Act, and hence the case is of little value as a precedent in a jurisdiction where no such legislative sanction can be relied upon. Lord Halsbury intimated that a different result might perhaps be reached if the power should be used by the company in order to evade the rule that dividends cannot be paid out of capital.³ The difficulty of proving an actual fraudulent evasion would, however, always be great, so that the decision practically opens in many cases a convenient escape from that salutary rule. There is no reason for encouraging a company to resort to its borrowing powers before it has called in its entire capital.

In America, in early days, railway companies not infrequently agreed to pay "interest" to subscribers to their stock on the amount paid up by them respectively, until the road should be completed and become productive.⁴ The object of such an agreement was to induce the subscribers to pay promptly by giving a premium in the shape of interest to those who might pay promptly. If the decision of the House of Lords in *Lock v. Queensland Co.* were applied to such cases, the interest might be payable out of capital, and to that effect were some decisions.⁵ On the other hand, other cases held that the interest was not payable until the road should be completed and sufficient profits earned.⁶ Still other cases merely affirmed the validity

¹ *Re Alexandra Palace Co.*, 21 Ch. D. 149 (overruling *Bardwell v. Sheffield Waterworks Co.*, 14 Eq. 517); *Macdougall v. Jersey Imperial Hotel Co.*, 2 Hem. & Miller, 528.

Cf. *Hinds v. Buenos Ayres, etc. Tramways Co.* (1906), 2 Ch. 654; and supra, § 542. See also Stat. 7 Ed. VII. c. 50 (Companies Act, 1907), § 9.

² *Lock v. Queensland, etc. Co.* (1896), A. C. 461.

Cf. *Fisher v. Hull, etc. Ry. Co.*, 25 Sol. J. 353.

³ (1896) A. C. 467.

⁴ See supra, § 548.

⁵ Cf. *Pittsburg, etc. R. R. Co. v. County of Allegheny*, 63 Pa. St. 126 (where the company was specially authorized by statute to pay the "interest").

⁶ *Wright v. Vermont, etc. R. R. Corp.*, 12 Cush. (Mass.) 68; *Waterman v. Troy, etc. R. R. Co.*, 8 Gray (Mass.) 433; *Rutland, etc. R. R. Co. v. Thrall*, 35 Vermont 536; *Painesville, etc. R. R. Co. v. King*, 17 Oh. St. 534.

Cf. *National Funds Ass. Co.*, 10 Ch. D. 118, 125.

of the stipulation without passing on the question whether the interest was payable out of capital or merely out of profits.¹

§ 1341. **Rule that Dividends cannot be paid by an insolvent Company distinguished from Rule that Dividends can be paid only out of Profits.** — The rule that dividends must not be paid out of capital is not the same as the rule that dividends must not be paid by an insolvent corporation. For, even an insolvent corporation may earn profits; but these profits must be used in paying its debts. To distribute them among the shareholders, indeed, would be a clear fraud upon creditors, and for this reason is prohibited. Conversely, a corporation may be quite solvent and yet may have earned no profits, and may therefore be unable lawfully to pay dividends.²

§ 1342. **Payment of Dividends by public-service Corporation before complete Discharge of its public Duties.** — Of course, a railway company cannot be enjoined by a shareholder from paying dividends because its line has not been completed and cannot be completed without additional capital:³ such facts disclose, at worst, a breach of public duty of which only the state can complain, and do not at all indicate that profits have not been earned.

§ 1343. **By-laws and restrictive Regulations as to Funds available for Dividends.** — The by-laws or regulations of some corporations prohibit the payment of dividends in some cases where they would be permitted by general law.⁴ Thus, in some English companies, dividends were by the regulations made payable only out of "realized profits."⁵ This means more than

¹ *Evansville, etc. R. R. Co. v. Evansville*, 15 Ind. 395, 414-415; *Racine County Nat. Bank v. Ayres*, 12 Wisc. 512.

² But see *Miller v. Bradish*, 69 Iowa 278; 28 N. W. 594 (where it seems to have been thought, if not held, that dividends may lawfully be paid where the assets of the company exceed its liabilities, the capital not being reckoned as a liability).

³ *Browne v. Monmouthshire Ry. & Canal Co.*, 13 Beav. 32.

⁴ As to a statute forbidding the distribution of dividends until a surplus shall have been accumulated in addition to the capital, see *Lapsley v. Merchants' Bank*, 78 S. W. 1095; 105 Mo. App. 98.

⁵ See *Oxford Bldg. Society*, 35 Ch. D. 502.

As to "surplus profits," see *Excelsior, etc. Mining Co. v. Pierce*, 90 Cal. 131; 27 Pac. 44; *People ex rel. Farnum v. San Francisco Savings Union*, 72 Cal. 199; 13 Pac. 498.

real profits honestly earned: it is the converse of *estimated profits*, and means if not "reduced to actual cash," at least "rendered tangible for the purpose of division."¹ "Net earnings" in a by-law describing the funds out of which the preferred dividend should be paid means such as are applicable to dividends.² Where it is provided that dividends shall not be paid except out of "surplus or net profits," a company cannot take into account expected profits on contracts for future delivery;³ and indeed it is very doubtful whether that could be done even without such an express provision.

§ 1344. **Presumption that Dividends actually declared were lawful.** — Where a dividend has been declared there is always a presumption that the action of the company was lawful and that there were sufficient profits to justify the declaration.⁴

§ 1345-§ 1347. *Withholding Dividends that have been earned — Right to accumulate Profits.*

§ 1345. **In general — Ownership of Accumulated Profits.** — In many cases the payment of dividends although not strictly illegal would be exceedingly bad business policy; and it is accordingly well settled that, save upon preferred shares,⁵ a company is not under any ordinary conditions required to declare a dividend.⁶ Profits, although earned, do not belong to

¹ *Oxford Bldg. Society*, 35 Ch. D. 502, 510.

Cf. *London & General Bank*, 72 L. T. 227.

² *Belfast, etc. R. R. Co. v. Belfast*, 77 Me. 445; 1 Atl. 362.

As to "net profits," see *Park v. Grant Locomotive Works*, 40 N. J. Eq. 114, 121; 3 Atl. 162.

³ *Hutchison v. Curtiss*, 45 N. Y. Misc. 484; 92 N. Y. Supp. 70.

⁴ *Redhead v. Iowa Nat. Bank*, 127 Iowa 572; 103 N. W. 796; *Balch v. Hallet*, 10 Gray (Mass.) 402; *Walker v. Walker*, 68 N. H. 407 (headnote inadequate); 38 Atl. 432.

⁵ See supra § 560, § 561.

⁶ *Burland v. Earle* (1902), A. C. 83, 95 (where the profits were not

accumulated as a reserve *eo nomine*, but were carried to the credit of profit and loss); *Knapp v. S. Jarvis Adams Co.*, 135 Fed. 1008; 70 C. C. A. 536; *Posner v. Southern Exhaust, etc. Co.*, 109 La. 658; 33 So. 641; *Beveridge v. New York Elevated R. R. Co.*, 112 N. Y. 1; 19 N. E. 489; 2 L. R. A. 648 (where the court refused to compel declaration of a dividend out of moneys payable by a lessee company equal in amount to a certain per centum on shares of the lessor); *Pratt v. Pratt, Read & Co.*, 33 Conn. 446; *Karnes v. Rochester, etc. R. R. Co.*, 4 Abb. Pr. N. s. (N. Y.) 107; *Smith v. Prattville Mfg. Co.*, 29 Ala. 503; *Burden v. Burden*, 159 N. Y. 287; 54 N. E. 17; *Reynolds v. Bank of Mt. Vernon*,

the several shareholders, but to the company in its corporate capacity, until the company chooses to declare a dividend out of them. Consequently, upon a bill for specific performance of a contract to issue shares to the plaintiff, it is error to require the company to pay the plaintiff his share of the undivided profits.¹ *A fortiori*, a shareholder has no right to a dividend on the ground that profits would have been earned if the company had not been mismanaged.² As a dividend cannot become payable unless it is first declared, an allegation that a dividend had accrued and had become due and payable has been held to be a sufficient allegation that a dividend had been declared.³ Moreover, a court of equity will not restrain a corporation which has a surplus in excess of its actual capital but not in excess of its needs from applying such surplus to an extension of the company's business.⁴ Many corporations, indeed, especially banks and trust companies, often accumulate their profits to an amount largely in excess of their nominal capital. The accumulated surplus belongs to the corporation and not to the shareholders, although the company might if it should see fit distribute the surplus as dividends.⁵

It is said, however, that in a clear case of abuse of this discretion, a court of equity will overrule the company's decision, and compel the declaration of a dividend.⁶ For instance, if a corporation withholds dividends which have been earned, for the purpose of defrauding a shareholder who has pledged his shares to the company to secure a debt which the dividends if declared

6 N. Y. App. Div. 62; 39 N. Y. Supp. 623; affirmed short in 158 N. Y. 740; 53 N. E. 1131; *Hunter v. Roberts, Throp & Co.*, 83 Mich. 63; 47 N. W. 131; *Zellerbach v. Allenberg*, 99 Cal. 57; *Wolfe v. Underwood*, 96 Ala. 329; *State v. Bank of La.*, 6 La. 745; *State v. Bank of La.*, 5 Mart. N. s. (La.) 327; *State v. B. & O. R. Co.*, 6 Gill (Md.) 363; *Stevens v. U. S. Steel Corp.* (N. J.), 59 Atl. 905 (where the reserved profits although amounting to \$66,000,000 were only six per cent upon the company's capital); *Schell v. Alston Mfg. Co.*, 149 Fed. 439 (where plaintiff sought to compel declaration of a stock dividend);

Corgan v. George F. Lee Coal Co. (Pa.), 67 Atl. 655.

¹ *Harris v. San Francisco Sugar Ref. Co.*, 41 Cal. 393.

² *Leary v. Columbia River, etc. Co.*, 82 Fed. 775.

³ *Hill v. Atoka Coal, etc. Co.* (Mo.), 21 S. W. 508.

⁴ *Pratt v. Pratt, Read & Co.*, 33 Conn. 446.

⁵ *Bryan v. Sturgis Nat. Bank* (Tex.), 90 S. W. 704, and cases cited supra, p. 1110, n. 6.

⁶ *Crichton v. Webb Press Co.*, 36 So. 926; 113 La. 167; 104 Am. St. Rep. 500; 67 L. R. A. 76; *Knapp v. S. Jarvis Adams Co.*, 135 Fed. 1008; 70 C. C. A. 536 (semble);

would suffice to pay, a court of equity will decree an accounting and charge the company with the amount of the dividends which ought to have been declared.¹ A bill of this sort by a common shareholder to compel a declaration of dividends by the company is founded upon the collective rights of the shareholders, and not on any individual rights of the plaintiff, and consequently will not lie unless the complainant has exhausted his remedies within the corporation.² While the directors may be proper parties defendant, it would seem that they are not necessary parties; and at any rate the corporation is a necessary and the most important defendant.² Of course, it is too late to maintain any suit to require a declaration of a dividend, if the company has become insolvent so that all its accumulated profits are needed to pay its debts.⁴ It is submitted that in order to maintain a bill of this kind, it is not sufficient to show that the discretion of the company has been unwisely exercised and that profits are being accumulated to a greater amount than good business policy requires: it is necessary to go further and show that the majority have been actuated by some bad motive — such as a desire to “freeze out” the poorer shareholders — or at any rate some motive other than the welfare of the company. But this principle has sometimes been overlooked.⁵

§ 1346. **Statutes requiring periodic Distribution of Profits as Dividends.** — Sometimes statutes require an annual distribution of all profits. Even in such cases, however, the right to

Raynolds v. Diamond Mills Paper Co. (N. J.), 60 Atl. 941 (headnote misleading, the accumulation of profits so as to double the company's capital in ten years held not an abuse of discretion); *Scott v. Eagle Ins. Co.*, 7 Paige (N. Y.) 198; *Beers v. Bridgeport Spring Co.*, 42 Conn. 17 (semble); *Hiscock v. Lacy*, 9 N. Y. Misc. 578; 30 N. Y. Supp. 860; *Laurel Springs Land Co. v. Fougerey*, 50 N. J. Eq. 756; 26 Atl. 886; *Hunter v. Roberts, Throp & Co.*, 83 Mich. 63; 47 N. W. 131 (semble); *Wolfe v. Underwood*, 96 Ala. 329 (semble); *Morey v. Fish Bros. Wagon Co.*, 108 Wisc. 520; 84 N. W. 862; *State v. Bank of La.*, 5 Mart. n. s. (La.) 327; *Stevens v. U. S. Steel Corp.* (N. J.), 59 Atl. 905 (semble).

¹ *Anderson v. W. J. Dyer & Bro.*, 101 N. W. 1061 (headnote inadequate); 94 Minn. 30.

² *Maeder v. Buffalo Bill's Wild West Co.*, 132 Fed. 280, 284.

³ *Stevens v. U. S. Steel Corp.* (N. J.), 59 Atl. 905.

⁴ *Scott v. Eagle Fire Ins. Co.*, 7 Paige (N. Y.) 198.

⁵ See *Crichton v. Webb Press Co.*, 36 So. 926; 113 La. 167; 104 Am. St. Rep. 500; 67 L. R. A. 76, and other cases cited supra, p. 1111, n. 6.

annual distribution may be waived by the shareholders by the unanimous adoption of a by-law vesting in the directors the discretionary power to accumulate a surplus.¹ Moreover, even where a statute requires the directors to distribute all surplus profits except such sum if any as the shareholders may direct to be reserved as a working capital, the mere fact that a large surplus is on hand will not entitle a minority shareholder to enforce its distribution.² So too, a statute providing that a company may divide its profits among its shareholders at such times as it may deem expedient does not prohibit a total omission to divide profits for a long period of time.³ A statute enacting that unless otherwise provided in the incorporation paper or by-laws the directors shall in January of each year declare a dividend of all accumulated profits, does not merely authorize a clause in the incorporation paper or by-laws fixing some other month than January for the distribution, but authorizes a clause dispensing with compulsory annual distribution of profits.⁴ The remedy under statutes requiring profits to be distributed is in equity and not by mandamus.⁵ Of course, such statutes do not prevent the company from agreeing to pay an employee a share in the profits of the company in lieu of wages;⁶ for the profits which are to be divided among the shareholders are reckoned only after deducting such charges.

§ 1347. **By-laws requiring that Profits be distributed.** — By-laws or internal regulations sometimes give to common shareholders a right to insist on the declaration of dividends out of profits remaining after payment to the preferred cumulative shareholders of their preferential dividends.⁷ A by-law requiring net profits remaining after payment of the preferential dividend on pre-

¹ *Raynolds v. Diamond Mills Paper Co.* (N. J.), 60 Atl. 941 (head-note misleading).

² *Trimble v. American Sugar Refining Co.*, 48 Atl. 912; 61 N. J. Eq. 340; *Lillard v. Oil, Paint & Drug Co.* (N. J.), 56 Atl. 254 (where the motive of the shareholders in directing the reservation was impugned by the complainant).

But cf. *Griffing v. Griffing Iron Co.* (N. J.), 48 Atl. 910; 61 N. J. Eq. 269.

³ *Barry v. Merchants' Exchange Co.*, 1 Sandf. Ch. (N. Y.) 280, 304.

⁴ *Stevens v. U. S. Steel Corp.* (N. J.), 59 Atl. 905.

⁵ *Rex v. Bank of England*, 2 B. & Ald. 620.

⁶ *Bennett v. Milville Imp. Co.*, 51 Atl. 706; 67 N. J. Law 320.

⁷ Cf. *McLaughlin v. Detroit, etc. Ry. Co.*, 8 Mich. 100.

See also, *supra*, § 548 and § 1340 as to "interest-bearing stock."

ferred shares to be divided annually among the common stockholders if a majority of the latter so demand has the force of a contract and as such will be enforced by the courts if the company fails to live up to it.¹ A provision in the company's incorporation paper for the distribution of so much of the profits as the directors should deem expedient does not prevent the directors from refusing to declare any dividend at all, even when profits have been earned, but remits the entire matter to their discretion.²

§ 1348. **Issue of Scrip in lieu of passed Dividends entitling Holder to Payment in the Future.** — Moreover, corporations which find themselves unable to meet the expectations of their shareholders by declaring a dividend at the anticipated time sometimes issue, in lieu of cash dividend, scrip-certificates payable at such time as sufficient profits shall be in hand. The rights of such certificate-holders to insist that profits when earned be distributed to them and not accumulated indefinitely are somewhat the same as the rights of preferred shareholders would be.³ Similar scrip-certificates have been issued where the company is restricted by statute from paying dividends at more than a certain rate and is without power to issue additional shares of capital stock. The objection that in such cases the issue of the scrip is unlawful as an evasion of the law does not seem to have been raised.⁴

§ 1349-§ 1351. *Times for Payment of Dividends.*

§ 1349. **Regular periodic Payment.** — Although dividends do not, like interest, accrue *de die in diem*,⁵ yet most prosperous com-

¹ *Seattle Trust Co. v. Pitner*, 18 Wash. 401; 51 Pac. 1048.

² *Ely v. Sprague*, 1 Clarke Ch. (N. Y.) 351.

³ Cf. *Barnard v. Vermont, etc. R. Co.*, 7 Allen (Mass.) 512; *Cunningham v. Vermont, etc. R. R. Co.*, 12 Gray (Mass.) 411; *Billingham v. Gleason, Mfg. Co.*, 101 N. Y. App. Div. 476; 91 N. Y. Supp. 1046.

⁴ *Bailey v. Railroad Company*, 22 Wall. 604 (where the scrip was held taxable as a "scrip dividend.")

⁵ *Clapp v. Astor*, 2 Edw. Ch. 379; *Foote, Appellant*, 22 Pick. (Mass.) 299; *Mann v. Anderson*, 106 Ga. 818; 32 S. E. 870.

But see *Bates v. Androscoggin, etc. R. R. Co.*, 49 Me. 491; *Ex parte*

panies have regular dividend periods, the dividends being payable quarterly, semi-annually, etc. In such cases the dividends may be deemed to be declared for the period then last elapsed.¹ Hence, a statute expressed to be applicable to companies which have paid dividends “continuously” applies to any corporation which has paid dividends at regular periods without intermission.² A “dividend paying security” means a security which is actually paying dividends and paying them regularly, and not a security which *may* pay a dividend.³

§ 1350. **By-laws and Statutes regulating Times for Dividends.** — The time of declaration of dividends is an appropriate subject for regulation by by-law, and is sometimes governed by statutory provision. A statute providing for the distribution of all accumulated profits of the company in January of each year, “unless some specific day or days for that purpose be fixed in its charter or by-laws,” has been held not merely to compel the directors to declare a dividend at that time, but also to prevent them from declaring dividends at any other time without previous authority in the by-laws.⁴

§ 1351. **Dividends declared hastily in order to avoid Payment to a Person about to become a Shareholder.** — A dividend is not illegal because its immediate declaration was determined upon in order to avoid payment to a particular person who was about to become a shareholder.⁵

§ 1352-§ 1354. *What a Declaration of a Dividend is.*

§ 1352. **In general.** — The declaration of a dividend does not differ from any other resolution of the directors or of the company.⁶ It is, therefore, unnecessary to consider here what is sufficient to constitute a resolution declaring a dividend. A resolution that the company pay the taxes assessed against the holders of its shares has been held to amount to the declaration

Rutledge, 1 Harp. Eq. (S. Car.) 65;
14 Am. Dec. 696 (distinguished but
approved in *Abercrombie v. Riddle*,
3 Md. Ch. 320, 330).

³ *Chappelle v. Chappelle* (Ky.), 99
S. W. 959.

⁴ *Marquand v. Federal Steel Co.*,
95 Fed. 725.

¹ *United States Steel Corp. v.*
Hodge, 64 N. J. Eq. 807, 820; 54
Atl. 1.

⁵ *Nicholson v. Rhodesia Trading*
Co. (1897), 1 Ch. 434.

² *United States Steel Corp. v.*
Hodge, 64 N. J. Eq. 807; 54 Atl. 1. ⁶ As to what is deemed to amount
to the declaration of a dividend, see
further, *infra*, § 1370.

of a dividend equal to the taxes on each share.¹ The setting aside or segregation of a fund to pay the dividend is not at all a necessary part of the declaration of the dividend.²

§ 1353. **Whether Time for Payment must be fixed.** — The declaration of a dividend may be efficacious although no time for payment be fixed. Indeed, a declaration of a dividend payable at such time as the directors may subsequently appoint is valid, the legal effect of the resolution being that the dividend is payable within a reasonable time.³

§ 1354. **Requirement of Equality.** — One of the requisites of a valid dividend is that it shall be payable *pro rata* among all shareholders of the same class.⁴ If a company undertakes to declare a dividend on all shares except those owned by a certain person, it has been held that the holder of those shares may treat the declaration of a dividend as valid, and the attempted exception of his shares as void, and that accordingly he may sue to recover his proportion of the dividend.⁵

If the company upon receiving from any source a large profit distributes the amount thereof among the shareholders as a dividend and wrongfully refuses to pay to one shareholder his proportion whereby the amounts payable to the other shareholders are increased, the shareholder so excluded cannot sue the other shareholders for money had and received to his use, but must look to the company alone.⁶ But if another person by claiming title to the plaintiff's shares collects the dividends thereon, the plaintiff as the true owner of the shares may recover the amount of the dividends from the interloper.⁷

¹ *Redhead v. Iowa Nat. Bank*, 127 Iowa 572; 103 N. W. 796.

² *McLaran v. Crescent Planing Mill Co.*, 117 Mo. App. 40; 93 S. W. 819.

³ *Beers v. Bridgeport Spring Co.*, 42 Conn. 17; *Billingham v. Gleason Mfg. Co.*, 101 N. Y. App. Div. 476; 91 N. Y. Supp. 1046.

⁴ Cf. *Luling v. Atlantic Mut. Ins. Co.*, 45 Barb. (N. Y.) 510, 30 How. Pr. 69; *Rider v. Alton, etc. R. R. Co.*, 13 Ill. 516; *Redhead v. Iowa Nat. Bank*, 127 Iowa 572, 575–576 (head-note inadequate); 103 N. W. 796 (relating to a dividend to enable

the shareholders to pay taxes levied upon their shares); *Redhead v. Iowa Nat. Bank*, 98 N. W. 806; 123 Iowa 336 (relating to the same dividend); *State v. B. & O. R. R. Co.*, 6 Gill (Md.) 363, 387.

See also *supra*, § 518, § 519, and *infra*, p. 1119.

⁵ *Hill v. Atoka Coal, etc. Co. (Mo.)*, 21 S. W. 508.

Cf. *Jones v. Terre Haute, etc. R. R. Co.*, 57 N. Y. 196.

⁶ *Peckham v. Van Wagenen*, 83 N. Y. 40; 38 Am. Rep. 392.

⁷ See *supra*, § 940.

§ 1355-§ 1356. *How Dividends may be Paid.*

§ 1355. **Borrowing Cash to pay Dividends.** — Where profits available for a dividend have been earned, but have been invested or expended on capital account, or are for any reason not readily convertible into cash, the company may borrow the money wherewith to pay the dividend.¹ But of course the company has no right to borrow money for the purpose of paying dividends which have not been earned; and money lent for that purpose, if the lender was privy thereto, cannot be recovered.²

§ 1356. **Payment in Shares, Bonds, etc., otherwise than in Cash.** — It has been held in England that articles of association which authorize directors to declare a dividend “to be paid” to the shareholders contemplate payment in money and impliedly prohibit a dividend in property of any kind, unless each shareholder have an option to take the dividend in cash; and accordingly where the company is governed by such articles of association, an English court at the instance of any shareholder will enjoin payment of dividends in coupon bonds or debentures.³ This decision turns on the construction of particular articles of association; and the construction adopted is certainly a literal and rather narrow one. In another English case, the rule seems to have been laid down by Lord Cairns that affirmative authority, conferred either by statute or by the regulations of the company, is necessary in order to justify a dividend in shares, bonds, or scrip, or otherwise than in cash.⁴ However, the English text-

¹ *Stringer's Case*, 4 Ch. 475; *Mills v. Northern Ry. of Buenos Ayres*, 5 Ch. 621; *Excelsior, etc. Co. v. Pierce*, 90 Cal. 131; 27 Pac. 44; *Williams v. Western Union Tel. Co.*, 93 N. Y. 162, 192 (semble); *State v. B. & O. R. R. Co.*, 6 Gill 363, 385 (semble).

As to paying dividends when the actual cash necessary is not in hand, see further, *London & General Bank*, 72 L. T., N. S., 227; *Miller v. Bradish*, 69 Iowa 278; 28 N. W. 594.

² *Davis v. Flagstaff Silver Mining Co.*, 2 Utah 74.

³ *Wood v. Odessa Waterworks*, 42 Ch. D. 636.

⁴ *Hoole v. Great Western Ry. Co.*, 3 Ch. 262. Lord Cairns said that if all the shareholders are not willing to accept the shares offered to them as a dividend, “every shareholder in the company who is so inclined has the clearest right to have them turned into money and to have the money rateably divided among the shareholders.” Rolt, L. J., the other judge who participated in the decision, rested his judgment on the special terms of certain statutes by which the company was governed — a *ratio decidendi* less open to criticism. See *supra*, § 596.

writers agree that special provision in a company's articles of association may authorize a dividend payable in property or in shares.¹ If the text-writers be correct in this opinion, as no doubt they are, the decisions in *Wood v. Odessa Waterworks* and *Hoole v. Great Western Railway Co.*, will do but little actual harm; but nevertheless, it is submitted that those decisions, and more particularly the *dicta* in the last-mentioned case, are very questionable. Why should not a corporation which has earned sufficient profits for the declaration of a dividend, but which desires to retain them in its business or which does not desire to sell at a sacrifice the property representing them, in order to raise the necessary cash for paying the dividend — why should not a corporation under such circumstances pay the dividend in property or in shares? It is upon this principle that so-called "stock dividends" are to be supported.

Accordingly, although a comparatively early New York case lends support to the doctrine that dividends cannot be declared payable in anything but money,² yet the later cases in New York as well as in other states discountenance this view.³ The true rule is submitted to be as follows: "There is no statute which requires dividends in telegraph companies or in companies generally to be made in cash. Whether they shall be made in cash or property must also rest in the discretion of the directors. There is no rule of law or reason founded upon public policy which condemns a property dividend. The directors could convert the property into cash before a dividend and divide that. So the shareholders can take the property divided to them and thus realize the cash. Within the domain of the law, it can make no material difference which course is pursued. If, however, a dividend be made payable in cash or payable generally, the corporation becomes a debtor, and must discharge such debt, as it

¹ 1 Lindley on Companies, 6th ed., p. 609; 1 Palmer's Company Precedents, 9th ed., pp. 615, 637.

² *Ehle v. Chittenango Bank*, 24 N. Y. 548.

³ See supra, § 596, as to stock dividends. As to whether a "stock-dividend" is comprised within the general term "dividends," see supra, § 596.

As to the enforceability of scrip

convertible into bonds issued in lieu of a cash dividend, see *Chaffee v. Rutland R. R. Co.*, 55 Vt. 110.

As to promissory notes given in payment of unearned dividends, see *Alabama Marble, etc. Co. v. Chattanooga Marble, etc. Co.* (Tenn.), 37 S. W. 1004.

As to setting off debts due by shareholders against a dividend, see infra, § 1361.

is bound to discharge all its debts, in lawful currency.¹ It is true that a shareholder cannot be compelled to receive property divided to him.² So he cannot be compelled to take a cash dividend. In case of his refusal to take a cash dividend the corporation may retain it for him until he shall demand it. In case he shall refuse to take a property dividend, the corporation may retain it and hold it in trust for him until he shall demand it, or possibly sell it for his benefit. If such a case shall ever arise, the courts will find some way to dispose of it. So this plaintiff cannot be compelled to accept the stock divided to him, and thus incur the possible liability which it may impose upon him as a stockholder. In case of his refusal, the corporation will find some way to deal with the stock which the law will sanction, but which need not now be pointed out."³ At any rate, where the corporation declares a dividend payable in stock, bonds, or other property the shareholder cannot elect to take cash in lieu of the stock or property offered to him; he must take what is offered him or do without anything.⁴ If a dividend is paid in property, the company does not warrant the title thereto.⁵

The declaration of a dividend payable to the large shareholders in bonds and to the small shareholders in cash is an undue discrimination;⁶ but wherever a dividend is payable in shares or bonds or other similar property there is great difficulty in avoiding such discrimination altogether; and the issue of scrip to the small shareholders redeemable when presented in amounts equalling one or more shares, does not wholly avoid the evil, inasmuch as the small shareholders may find themselves unable to dispose of the scrip except at a sacrifice, and may not have the means to purchase the requisite fractional amount of scrip to secure one share or bond.

¹ Accord: *Scott v. Central R. R., Hubbell*, 115 Mass. 461, 478; 15 Am. etc. Co., 52 Barb. 45. Rep. 121.

² See *State v. B. & O. R. R. Co.*, 6 Gill 363, 385. But see *Ehle v. Chittenango Bank*, 24 N. Y. 548 (held, that a dividend declared payable in "New York

³ *Williams v. Western Union Tel. Co.*, 93 N. Y. 162, 192-193, per Earle, J. State currency" could be paid only in legal money).

⁴ *State v. Baltimore, & O. R. R. Co.*, 6 Gill (Md.) 363. ⁵ Cf. *Olsen v. Homestead Land, etc. Co.*, 87 Tex. 368; 28 S. W. 944.

⁶ Cf. *Harris v. San Francisco Sugar Ref. Co.*, 41 Cal. 393, 408; *Rand v. Co.*, 6 Gill (Md.) 363, 387.

§ 1357-§ 1361. *Rights of Shareholders against the Company in Consequence of a Declaration of a Dividend.*

§ 1357. **Declared Dividends as Debts of Corporation—Remedies for Non-Payment.** — The effect of the valid declaration of a dividend is that the amount payable to each shareholder becomes an ordinary debt due to him by the company. If the dividend was properly declared — that is to say, if sufficient profits were in hand — the several shareholders stand as creditors of the company; and if the company subsequently becomes insolvent they are entitled to prove in competition with other creditors for any unpaid portions of the declared dividend.¹ The right of each shareholder to his portion of the dividend is an individual right and may be enforced by an action of debt or assumpsit against the company,² or, as it has been held, by a bill in equity,³ although any good reason for equitable jurisdiction is not in ordinary cases apparent.⁴ Mandamus is not an appropriate remedy to compel payment of a declared dividend.⁵

No action lies against the company's treasurer individually because of refusal or neglect to pay to a complaining shareholder his proportion of a dividend;⁶ and so directors are not proper parties to a proceeding to enforce payment of a declared

¹ For a case where a shareholder by entering into a reorganization agreement was held to have waived his right to stand as creditor in respect of a judgment against the company for unpaid dividends, see *Farmers' L. & T. Co. v. Central R. etc. Co.*, 120 Fed. 1006.

² *Jackson v. Newark Plank Road Co.*, 31 N. J. Law 277 (assumpsit); *King v. Paterson, etc. R. R. Co.*, 29 N. J. Law 82 (assumpsit for money had and received to plaintiff's use), affirmed 29 N. J. Law 504.

Cf. *Kane v. Bloodgood*, 7 Johns. Ch. (N. Y.) 90, 109 (where Chancellor Kent said that a common law action of account would lie, or probably assumpsit for money had and received).

³ *Beers v. Bridgeport Spring Co.*,

42 Conn. 17; *Cook County Brick Co. v. Kaehler*, 83 Ill. App. 448.

Cf. *Dupignac v. Bernstrom*, 83 N. Y. Supp. 350 (where at the instance of a shareholder who had made out a *prima facie* case to five per cent of the dividends, the court enjoined the payment of more than ninety-five per cent of the earnings to the other shareholders).

⁴ *Searles v. Gebbie*, 115 N. Y. App. Div. 778, 780 (headnote inadequate).

⁵ *People ex rel. Van Norman v. Central Car, etc. Co.*, 41 Mich. 166; 49 N. W. 925.

⁶ *French v. Fuller*, 23 Pick. (Mass.) 108.

Cf. *Williams v. Fullerton*, 20 Vt. 346 (action maintainable when treasurer claims title himself to plaintiff's shares).

dividend,¹ unless they have become trustees of a fund specially set apart for that object.

Of course, the claim of a shareholder against the company for a dividend which has been declared and not paid is not entitled to any preference over the claims of outside creditors,² unless indeed the company has hypothecated some of its property or impressed it with a trust for the payment of the dividend. If a special fund is deposited by the company with its bankers for the payment of the dividends, that fund may be stamped with a trust in favor of the several shareholders.³

§ 1358. **Revocation of Dividend after Declaration.** — As a dividend when declared becomes a debt of the company, it follows that a dividend, once properly declared, cannot be revoked.⁴ This is true even though the directors attempted to reserve to themselves power to determine when the dividend should be payable.⁵ It has been held, however, that where a dividend is declared payable at a future time the directors may rescind the action at a subsequent meeting held before the declaration of the dividend has been communicated to the shareholders.⁶ Indeed, a recent English case goes rather further than this, and upholds a revocation of a dividend even after the declaration has been advertised in the newspapers.⁷ Moreover, if after an attempt to rescind the declaration of a dividend, another dividend is declared expressed to be in lieu of the previous revoked dividend, no shareholder can justly claim both, but the acceptance of the second dividend is a bar to the maintenance of an action for the first.⁸ Of course, a dividend which was improperly declared at a time when no sufficient profits were

¹ *Searles v. Gebbie*, 115 N. Y. App. Div. 778. *Planing Mill Co.*, 117 Mo. App. 40; 93 S. W. 819.

² *Hunt v. O'Shea*, 69 N. H. 600; 45 Atl. 480; *Lowene v. American Fire Ins. Co.*, 6 Paige (N. Y.) 482. ⁵ *Beers v. Bridgeport Spring Co.*, 42 Conn. 17.

³ *Re Le Blanc*, 14 Hun 8, affirmed short in 75 N. Y. 598, *Le Roy v. Globe Ins. Co.* (N. Y.), 2 Edw. Ch. 657. ⁶ *Ford v. Easthampton Rubber Co.*, 158 Mass. 84; 32 N. E. 1036; 35 Am. St. Rep. 462; 20 L. R. A. 65 (savagely disapproved in *McLaran v. Crescent Planing Mill Co.*, 117 Mo. App. 40, 50-52; 93 S. W. 819).

Cf. *King v. Paterson, etc. R. R. Co.*, 29 N. J. Law 82, affirmed 29 N. J. Law 504. ⁷ *Lagunas Nitrate Co. v. Schroeder & Co.*, 85 L. T. 22.

⁴ *Albany Fertilizer, etc. Co. v. Arnold*, 103 Ga. 145, 148; 29 S. E. 695 (semble); *McLaran v. Crescent* ⁸ *Albany Fertilizer, etc. Co. v. Arnold*, 103 Ga. 145; 29 S. E. 695.

in hand, may and should be revoked, and no shareholder can compel payment.¹ Indeed, we shall see that if such an illegal dividend is paid it may be recovered back.

§ 1359. **Demand for Payment as prerequisite to Suit to recover Dividend — Interest and Limitations.** — In England the statute of limitations runs against the shareholder's right to a dividend from the time the dividend is made payable;² but in some of the United States it has been held that until demand is made upon the company, the shareholder cannot bring suit for a dividend,³ and that until then interest and the statute of limitations do not begin to run on or against his claim.⁴ For reasons of

¹ *Slayden v. Seip Coal Co.*, 25 Mo. App. 439. Cf. *Alabama Marble, etc. Co. v. Chattanooga Marble, etc. Co.* (Tenn.), 37 S. W. 1004 (where promissory notes had been given in payment of the unearned dividend).

But see *Chaffee v. Rutland R. R. Co.*, 55 Vt. 110 (where scrip obligations issued in lieu of dividends at a time when no profits were in hand were enforced when other shareholders than the plaintiff had been paid); *Stoddard v. Shetucket Foundry Co.*, 34 Conn. 542 (holding that where the other shareholders have received their proportion of an unearned dividend, plaintiff may recover his share).

² *Severn and Wye Ry. Co.* (1896), 1 Ch. 559. The same law has been laid down in some American cases: *Commonwealth for Mercer County Court v. Springfield, etc. Turnpike Co.*, 10 Bush (Ky.) 254.

But cf. *Bank of Louisville v. Gray*, 84 Ky. 565, 575; 2 S. W. 168; *Winchester, etc. Turnpike Co. v. Wickliffe*, 100 Ky. 531; 38 S. W. 866; 66 Am. St. Rep. 356.

³ *Hagar v. Union Nat. Bank*, 63 Me. 509, 512-513 (headnote inadequate); *Winchester, etc. Turnpike Co. v. Wickliffe*, 100 Ky. 531, 535; 38 S. W. 866; 66 Am. St. Rep. 356; (semble); *Ralston v. Bank of California*, 112 Cal. 208; 44 Pac. 476; *Scott v. Central R. R., etc. Co.*, 52 Barb. 45 (dealing also with the

questions what is a sufficient demand and what will excuse failure to make a demand before bringing suit).

Cf. *Robinson v. Nat. Bank of New Berne*, 95 N. Y. 637 (holding that distinct denial of title of plaintiff's assignor excused lack of demand by plaintiff); *Redhead v. Iowa Nat. Bank*, 127 Iowa 572; 103 N. W. 796 (allegation that defendant refused to pay sufficient without averment that plaintiff demanded payment).

⁴ *State v. B. & O. R. R. Co.*, 6 Gill 363, 387; *Philadelphia, etc. R. R. Co. v. Cowell*, 28 Pa. St. 329, 339; 70 Am. Dec. 128 (limitations); *Armant v. New Orleans, etc. R. R. Co.*, 41 La. Ann. 1020 (limitations); *Bank of Louisville v. Gray*, 84 Ky. 565, 575; 2 S. W. 168; (overruled(?) by *Winchester, etc. Turnpike Co. v. Wickliffe*, 100 Ky. 531; 38 S. W. 866; 66 Am. St. Rep. 356); *Mustard v. Union Nat. Bank*, 86 Me. 177; 29 Atl. 977 (interest); *Cochran v. McGee*, 53 S. W. 519 (interest).

Cf. *Larwill v. Burke*, 19 Oh. Circ. Ct. 513; *Bills v. Silver King Mining Co.*, 106 Cal. 9; 39 Pac. 43 (as to what amounts to a sufficient demand to start the statute of limitations running); *St. Romes v. Levee Steam Cotton Press*, 20 La. Ann. 381; *Kane v. Bloodgood*, 7 Johns. Ch. 90 (holding that the statute of limitations runs against a shareholder's claim

convenience, this latter doctrine is preferable. Indeed, it has been thought that where the company deposits in bank sufficient funds to pay the amount of the dividend, and notifies the several shareholders of such deposit, a shareholder who neglects to apply to the bank for the amount payable to him cannot charge the company with the loss occasioned by the subsequent insolvency of the bank.¹

§ 1360. **Further Consideration of Statute of Limitations as Defence — Right to Dividends as founded on Specialty or Written Instrument.** — An entry of the liability in the corporation's books, not communicated to the shareholder, will not take a dividend out of the statute of limitations.²

In England and Ireland, a holder of shares whose certificate is under the corporate seal is not barred from recovering dividends until the lapse of twenty years — the period of limitations applicable to actions on specialties — after the date of declaration.³ In Kentucky, it is held that where the resolution declaring the dividend is recorded among the records of the company the action to recover the dividend is founded upon that written resolution and is therefore governed by the period of limitations applicable to actions upon "written contracts."⁴

§ 1361. **Set-off of Debts owing by Shareholder against Dividends.** — The company may set off against a claim for dividends any liquidated claim it may have against the shareholder.⁵ This right of set-off is not based on any lien of the company on the shares for debts of the holders, but exists although no such lien

for dividends wrongfully withheld, but not specifically considering whether the period of limitations begins to run from the declaration of the dividend or from the demand and refusal to pay).

As to interest on dividends which the company was enjoined from paying, see *Heck v. Bulkley* (Tenn.), 1 S. W. 612. As to laches for a period short of that limited by the statute of limitations, see *Redhead v. Iowa Nat. Bank*, 127 Iowa 572; 103 N. W. 796.

¹ *King v. Paterson, etc. R. R. Co.*, 29 N. J. Law 82 (semble, Van Dyke, J., differing from his associates on this point).

² *Re Severn & Wye Ry. Co.* (1896), 1 Ch. 559.

³ *Artisans' Land & Mortgage Corp.* (1904), 1 Ch. 796; *Smith v. Cork, etc. Ry. Co.*, 5 Ir. Rep. Eq. 65, 75-76; *Drogheda Steam Packet Co.* (1903), 1 Ir. 512.

⁴ *Winchester, etc. Turnpike Co. v. Wickliffe*, 100 Ky. 531; 38 S. W. 866; 66 Am. St. Rep. 356.

⁵ *Whittington v. Farmers' Bank*, 5 H. & J. (Md.) 489. As to declaring a dividend to be set-off against the amount remaining unpaid on the shares, see *Kenton, etc. Mfg. Co. v. McAlpin*, 5 Fed. 737, 742-744; and *Ex parte Winsor*, 3 Story 411 (stated infra in text).

exists.¹ On the other hand, this right of set-off can be exercised only when the dividend becomes payable while the debtor continues to be shareholder.² It has even been held in Tennessee that if the company, before the dividend is actually paid but after it becomes payable, learns of the existence of an unregistered transfer by the debtor shareholder, the right of set-off is gone;³ but on principle it would certainly seem that if the company has no knowledge of the unrecorded transfer until the dividend has become payable and its right of set-off has become absolute, the right should not be divested because the company may subsequently learn of the prior transfer. In Maryland, it has been said *obiter* that where the company lends to the registered shareholder after the execution of a transfer by him and without knowledge thereof, the debt may be set off against a dividend subsequently declared,⁴ but unless the dividend was declared before the transfer was registered, it is submitted that this *dictum* cannot be supported. The company, in lending the money to the registered shareholder, cannot be taken to have relied on the potential right of set-off, but must be presumed to know that the set-off may be defeated by a transfer.

It was held in an early case before Judge Story that where a corporation first declares a dividend and then levies upon the shareholders a call or assessment of the same amount payable at the same time, the assessment must be set off against the

¹ *Sargent v. Franklin Ins. Co.*, 8 Pick. (Mass.) 90, 100 (semble); *Hagar v. Union Nat. Bank*, 63 Me. 509; *First Nat. Bank v. DeMorse* (Tex.), 26 S. W. 417; *Bates v. N. Y. Ins. Co.*, 3 Johns. Cas. (N. Y.) 238.

Cf. *Solomon v. First Nat. Bank*, 72 Miss. 854; 17 So. 383 (where by resolution of the directors the company's right of set-off was confined to such debts as were "not fully secured"); *American Nat. Bank v. Nashville Warehouse, etc. Co.* (Tenn.), 36 S. W. 960 (where set-off was impossible as the debts were not mutual, a firm of which the shareholder was a member being indebted to the company).

² *Brent v. Bank of Washington*, 2 Cranch C. C. 517 (where the divi-

dends were declared after the death of the debtor shareholder, and to be compared with *Brent v. Bank of Washington*, 10 Pet. 596); *Gemmell v. Davis*, 75 Md. 546, 551-552; 23 Atl. 1032; 32 Am. St. Rep. 412; *Bridges v. Nat. Bank of Troy*, 185 N. Y. 146 (debt due by shareholder individually not to be set off against a dividend in liquidation declared after the execution by the shareholder of a general assignment for the benefit of creditors).

³ *American Nat. Bank v. Nashville Warehouse, etc. Co.* (Tenn.), 36 S. W. 960 (headnote inadequate).

⁴ *Gemmell v. Davis*, 75 Md. 546, 553; 23 Atl. 1032; 32 Am. St. Rep. 412.

dividend, and virtually therefore nullifies and revokes the same, so that the company cannot apply the dividend in payment or set-off of another and unsecured indebtedness due from the shareholder, thus leaving the assessment as a lien upon the shares with priority over other creditors of the shareholders.¹

§ 1362. Liability of Directors for declaring and paying Dividends unlawfully. — The liability of directors for paying dividends which have not been earned is the same as their liability for making any payment out of the company's funds for an illegal or *ultra vires* purpose.² When sued for paying illegal dividends, the directors may defend themselves by showing that the payment was made under an honest, reasonable mistake of fact, as is more elaborately explained elsewhere.³ They cannot, however, recoup, or set off, profits earned by the company under another management after their retirement from office.⁴ Where directors borrow money wherewith to pay dividends when no profits have been earned, and where the company goes into liquidation before the loan is repaid, the result of the transaction is only to increase the amount of proofs against the company, and therefore the directors are not liable for the whole amount of the dividend, but only for such a sum as will enable the liquidator to pay on all the debts a dividend equal to that which would have been paid on all the debts (except this loan) if no proof had been made in respect of the loan.⁵

It has been held that directors who declare and pay dividends out of capital are not liable for so doing when recovery is sought by the corporation for the benefit of the shareholders who received the illegal dividends.⁶ These decisions appear at first blush to accomplish justice; but nevertheless it is submitted

¹ *Ex parte Winsor*, 3 Story 411.

² See *infra*, § 1517 et seq.

³ See *infra*, § 1523.

⁴ *Hutchinson v. Curtiss*, 45 N. Y. Misc. 484; 92 N. Y. Supp. 70.

⁵ *Alexandra Palace Co.*, 21 Ch. D. 149.

⁶ *Siegman v. Maloney*, 63 N. J. Eq. 422; 51 Atl. 1003 (affirmed on

the ground that complaining shareholder had shown no sufficient reason why the suit should not be wrought in the name of the corporation, 54 Atl. 405, 1125; 65 N. J. Eq. 372); *Emerson v. Gaither*, 103 Md. 564, 581; *Wallace v. Lincoln Sav. Bank*, 89 Tenn. 630, 641; 15 S. W. 448; 24 Am. St. Rep. 625.

that to hold the culpable directors liable to the corporate entity, leaving them to seek reimbursement from the several shareholders, would bring about in many respects the same result and would at the same time be more in harmony with legal theory.¹

Statutes frequently subject directors to various pains and penalties for declaring illegal dividends.² Such statutory liabilities should if possible be construed as cumulative and therefore not to deprive the company of its remedies at common law.³

§ 1363. **Liability for Misrepresentation inducing the Declaration of Dividends.** — If dividends are paid by the company in reliance upon false and fraudulent reports, accounts and statements prepared by an officer of the company or indeed by a third person, it has been held that the corporation may recover from the deceiver the amount paid out, in an action for deceit, even though the dividends were not paid out of capital, but out of money which was properly applicable (if the company had so resolved) to the payment of dividends.⁴ "The fact remains," said the court, "that by reason of the misrepresentation of the position of their affairs the company have parted with sums of money which, but for that misrepresentation, it may reasonably be assumed, would still be at their credit. The fact that the then shareholders received this money does not help the company back to their money; it is the company and not the shareholders who now sue to recover it; and it is evident (though that makes no difference in the principle) that the present shareholders are not the same as those who received the dividends. But for the misrepresentation the company would now be in the possession of so much more working capital."

§ 1364-§ 1368. *Liability of Shareholders who receive unlawful Dividends.*

§ 1364. **In general.** — Where dividends are improperly declared and paid out of capital, and are received by a shareholder with knowledge of the fact, he is bound to repay the amount

¹ Cf. *Northern Nav. Co. v. Long*, 96 S. W. 605. See also *infra*, 11 Ont. L. R. 230, 240-241. § 1549.

² See *Ellis v. French Canadian*, *etc. Ass'n*, 189 Mass. 566; 76 N. E. R. 493. ³ *Mackie v. Clough*, 17 Vict. L.

207; *Pennsylvania Iron Works v. Mackenzie* (Mass.), 76 N. E. 228; *Northern Nav. Co. v. Long*, 11 Ont. L. R. 230, 240-241. *City of Franklin v. Caldwell* (Ky.),

so received,¹ upon the principle that one who knowingly receives trust moneys is bound to make good the loss to the trust fund. Consequently, if the directors who authorized such improper dividend have been compelled to repay the same to the company or its receiver or liquidator, they have a right to be indemnified by each shareholder in respect of the dividend received by him.² Of course, the shareholders are not exonerated from liability to refund the illegal dividends merely because a statute expressly makes the directors liable for the amount wrongfully paid out.³ Where two dividends in succession have been declared, the first being paid out of capital, the shareholders cannot be required to refund both dividends unless it appear that the second could not have been legally paid even if the money used for the former had been retained by the company.⁴ A shareholder who receives the illegal dividend is not exonerated because, disclaiming ownership of the shares in question, he promptly pays over the amount of the dividend to a third person: in order to escape liability he should refund the dividend to the company.⁵

§ 1365. **Shareholders subsequently transferring their Shares.** — The liability to refund illegal dividends attaches to those persons who as shareholders received the dividend, so that they would not be discharged from their obligation by a subsequent transfer of their shares.⁶ This is true even where a statute provides that a transferee of shares "shall in proportion to his shares succeed

¹ Cf. *Gager v. Paul*, 111 Wis. 638; 87 N. W. 875; *Grant v. Southern Contract Co.*, 47 S. W. 1091; 104 Ky. 781; *Corn v. Skillern* (Ark.), 87 S. W. 142.

As to whether the shareholders who receive the illegal dividends incur any direct liability to creditors of the corporation, see *Vose v. Grant*, 15 Mass. 505 (action of tort by creditor against shareholder held not sustainable); *Spear v. Grant*, 16 Mass. 9 (action of assumpsit by creditor against shareholder held not sustainable); *Hastings v. Drew*, 76 N. Y. 9; *Wood v. Dummer*, 3 Mason 308; *Montgomery v. Whitehead* (Colo.), 90 Pac. 509.

² *Moxham v. Grant* (1900), 1 Q.

B. 88; *Lexington, etc. R. R. Co. v. Bridges*, 7 B. Monr. (Ky.) 556, 562 (semble).

But see *Appleton v. American Malting Co.*, 54 Alt. 454; 65 N. J. Eq. 375.

³ *Williams v. Boice*, 38 N. J. Eq. 364.

⁴ *Lexington, etc. Ins. Co. v. Page*, 17 B. Monr. (Ky.) 412, 441; 66 Am. Dec. 165.

⁵ *Finn v. Brown*, 142 U. S. 56; 12 Sup. Ct. 136; *Am. Steel & Wire Co. v. Eddy*, 138 Mich. 403; 101 N. W. 578.

⁶ *Holmes v. Newcastle-upon-Tyne Freehold Abattoir Co.*, 1 Ch. D. 682, 688 (semble).

to all the rights and be subject to all the liabilities of prior shareholders.”¹

§ 1366. **Effect of Lack of Notice of Illegality of Dividend.** — If the dividend is received by the shareholder without knowledge that it is paid out of capital, it has been held that he is not obliged to refund the same,² and that too although he is also a director and consented to the dividend, though under an innocent mistake of fact.³ The same rule has been applied where a statute expressly forbids shareholders to “withdraw or permit to be withdrawn, either in the form of dividends or otherwise, any portion of its capital.”⁴ It has even been held that a shareholder who has in good faith received and spent a dividend which was in fact paid out of capital can maintain a shareholder’s bill to compel the directors to repay to the company the amount of the illegal dividend.⁵ Inasmuch as the shareholders are mere volunteers, unless they have in some way changed their position in reliance upon the dividend, it is on

¹ *Hurlbut v. Tayler*, 62 Wisc. 607; 22 N. W. 855.

² *McDonald v. Williams*, 174 U. S. 397; 19 Sup. Ct. 743 (where the question was left open as to the shareholder’s liability if the company had been actually insolvent at the time of payment of the dividend).

But see *Mills v. Hendershot* (N. J. Ch.), 62 Atl. 542 (where the shareholders were held liable for the return of the dividend, without any discussion of the point); *Hayden v. Williams*, 96 Fed. 279; 37 C. C. A. 479 (where the company was insolvent when the dividend was declared); *Williams v. Boice*, 38 N. J. Eq. 364 (where the question was not discussed); *Lexington, etc. Ins. Co. v. Page*, 17 B. Monr. 412, 442-443; 66 Am. Dec. 165; *Grant v. Ross*, 100 Ky. 44; 37 S. W. 263; *Sagory v. Dubois*, 3 Sandf. Ch. (N. Y.) 466, 500.

³ *Re Denham Co.*, 25 Ch. D. 752; *Lucas v. Fitzgerald*, 20 Times L. R. 16.

Cf. *Great Western, etc. Mfg. Co.* (dend).

v. Harris, 128 Fed. 321, 332; 63 C. C. A. 51; *New Hampshire Sav. Bank v. Richey*, 121 Fed. 956, 960; 58 C. C. A. 294; *Main v. Mills*, 6 Biss. 98.

But see *Hayden v. Thompson*, 36 U. S. App. 361 (that defendants were not aware of the illegality of the dividend appears at p. 377); 71 Fed. 60; 17 C. C. A. 592; *Lexington, etc. Ins. Co. v. Page*, 17 B. Monr. 412; 66 Am. Dec. 165; *Finn v. Brown*, 142 U. S. 56 (headnote inadequate); 12 Sup. Ct. 136; *Ebelhar v. German Am. Sec. Co.* (Ky.), 91 S. W. 262.

⁴ *McDonald v. Williams*, 174 U. S. 397 (headnote inadequate); 19 Sup. Ct. 743.

⁵ *Appleton v. American Malting Co.*, 54 Atl. 454; 65 N. J. Eq. 375.

Cf. *Gaffney v. Colvill*, 6 Hill (N. Y.) 567, 575 (where shareholders who had received an illegal dividend without knowledge of the fact that it was paid out of capital were allowed to enforce a statutory liability of directors for declaring the dividend).

principle difficult to see why they should not be compelled to refund even though they were not aware of the unlawfulness of the dividend.¹

Of course, when dividends have been paid in good faith while the company is prosperous, the shareholders cannot be required to refund for the benefit of creditors, because, by a subsequent disaster, the company is reduced to hopeless insolvency.²

§ 1367. **Remedies for Enforcement of Liability.** — A suit in equity will lie by the company or its receiver or liquidator against a number of shareholders who have received their several proportions of dividends that were paid out of capital, and the bill will not be multifarious because of the joinder in one suit of claims against several shareholders some of whom did not participate in all the dividends.³ The ordinary remedy, however, is by action at law against each shareholder for money had and received.

§ 1368. **Statute of Limitations as Defence.** — The statute of limitations runs against the company's claim upon the shareholders for recovery of a dividend illegally paid, from the time of payment of the dividend.⁴ If the shareholder is also a director, it has been held that the statute of limitations is no bar to the claim for repayment of the dividend actually received by him, even though the claim against him for improperly declaring the dividend is barred by a statute of limitations which expressly applies to such a case;⁵ but the reason for this decision is not easy to see.

¹ Cf. *London Trust Co. v. Mackenzie*, 62 L. J. Ch. 870, 876; App. 361; 71 Fed. 60; 17 C. C. A. 592.

Am. Steel & Wire Co. v. Eddy, 101 N. W. 578; 138 Mich. 403 (enforcing a statutory liability for withdrawing capital notwithstanding a *bona fide* belief that profits had been earned to justify the dividend); *Crawford v. Roney* (Ga.), 61 S. E. 117.

² *Reid v. Eatonton Mfg. Co.*, 40 Ga. 98, 101; 2 Am. Rep. 563.

³ *Hayden v. Thompson*, 36 U. S. App. 361; 71 Fed. 60; 17 C. C. A. 592; *Lexington, etc. Ins. Co. v. Page*, 17 B. Monr. (Ky.) 412; 66 Am. Dec. 165; *Mills v. Hendershot* (N. J. Ch.), 62 Atl. 542. Cf. *Main v. Mills*, 6 Biss. 98.

⁴ *Hayden v. Thompson*, 36 U. S. App. 361, 375-378; 71 Fed. 60; 17 C. C. A. 592; *Lexington, etc. Ins. Co. v. Page*, 17 B. Monr. (Ky.) 412; 66 Am. Dec. 165; *Mills v. Hendershot* (N. J. Ch.), 62 Atl. 542. Cf. *Main v. Mills*, 6 Biss. 98.

⁵ *Mills v. Hendershot* (N. J. Ch.), 62 Atl. 542.

§ 1369-§ 1398. WHO ARE ENTITLED TO DIVIDENDS.

§ 1369-§ 1373. AS AGAINST THE CORPORATION.

§ 1369. **Of the Rule that the Company's Register of Shareholders determines the Right to Dividends as between the Shareholder and the Corporation.** — The company is always protected in paying dividends to those persons who are registered as shareholders on its books,¹ unless the books are erroneous through the company's own fault.² Indeed, one of the most important objects in keeping a list of shareholders is to afford this protection to the company. But the company may sometimes be deemed at fault within the meaning of this rule where it has acted honestly and without negligence — for example, where it has registered a forged transfer.³

A person who is not rightfully entitled to collect dividends as between himself and some third person cannot maintain an action against the company to compel it to pay the dividends to

¹ *Brisbane v. Delaware, etc. R. R. Co.*, 94 N. Y. 204; *Cleveland, etc. R. R. Co. v. Robbins*, 35 Oh. St. 483.

Cf. *Cook v. Monroe*, 45 Nebr. 349; 63 N. W. 800; *Price v. Morning Star Mining Co.*, 83 Mo. App. 470; *Bank of Commerce's Appeal*, 73 Pa. St. 59 (a strong case); *Northrop v. Newton Bridge Co.*, 3 Conn. 544 (which goes further than the authorities generally warrant).

As to the right of the company to maintain a bill of interpleader where the right to dividends is disputed, see *Price v. Morning Star Mining Co.*, 83 Mo. App. 470; *Hinckley v. Pfister*, 83 Wisc. 64, 84-85; 53 N. W. 21; *Salisbury Mills v. Townsend*, 109 Mass. 115; *Page Belting Co. v. Prince* (N. H.), 67 Atl. 401.

² *Robinson v. Nat. Bank of New Berne*, 95 N. Y. 637; *Hill v. Atoka Coal, etc. Co.* (Mo.), 21 S. W. 508 (transferee whom the company wrongfully refused to register as shareholder entitled to sue for divi-

dend without first compelling registration of the transfer); *Blooming-Grove Cotton Oil Co. v. First Nat. Bank*, 56 S. W. 552 (transferee under a transfer which company has wrongfully refused to register entitled to compel payment to him of dividend subsequently declared, although company may have paid it to the transferor, the registered holder); *Ashton v. Zeila Mining Co.*, 134 Cal. 408; 66 Pac. 494.

In *Hughes v. Vermont Copper Mining Co.*, 72 N. Y. 207, it was held that one claiming to be shareholder and whose title the corporation has wrongfully refused to recognize on its books cannot after electing to sue for a conversion of the shares recover dividends thereon. *Sed quære*, since only a judgment in trover — according to some authorities a satisfied judgment — and not the mere pendency of the action, affects the plaintiff's title to the converted property.

³ *Supra*, § 936.

him merely because he is the registered holder of the shares;¹ and conversely the third person can maintain an action to recover the dividends.² It has sometimes been held that if the company pays the registered holder with knowledge that as between himself and the third person the latter is alone entitled to collect the dividend, it is liable over again to such third person³ — a harsh and, it is submitted, unnecessary conclusion. Perhaps this line of cases may be supported on the ground that the company on learning of the equity of the third person ought to have made some entry thereof on its books. If the company pays to a person who is not the registered owner it certainly assumes the burden of showing that he and not the registered shareholder is entitled as between themselves to receive the dividend.⁴

§ 1370-§ 1373. *Of the Rule that the Person who is registered as Shareholder at the Time of Declaration of the Dividend is entitled to collect it from the Corporation.*

§ 1370. **In general — What Time is taken as the Date of Declaration of the Dividend.** — The person who is the registered holder at the time the dividend is declared is the person in whom, so far as the company is concerned, the right to the dividend vests.⁵ This is true even where the dividend is made payable at some later date, or where the time of payment is left to an agent of the company to determine.⁶ The practice of many companies is to declare a dividend in favor of the shareholders of record at

¹ *Bates v. Androscoggin, etc. R. R. Co.*, 49 Me. 491.

But see *Price v. Morning Star Mining Co.*, 83 Mo. App. 470, 477 (semble).

² Cf. *Robinson v. Nat. Bank of New Berne*, 95 N. Y. 637.

But see *Sargent v. Essex Marine Ry. Corp.*, 9 Pick. (Mass.) 202 (where a by-law provided that all transfers of shares should be made in the company's books); *Hughes v. Vermont Copper Mining Co.*, 72 N. Y. 207 (criticised supra, p. 1130, n. 2).

³ *Guarantee Co. v. East Rome Town Co.*, 96 Ga. 511; 23 S. E. 503; 51 Am. St. Rep. 150; *Central Nebr. Nat. Bank v. Wilder*, 32 Nebr. 454; 593.

49 N. W. 369; *Steel v. Island City, etc. Co.* (Oreg.), 83 Pac. 783 (where the company received notice of the third person's right after declaring the dividend and appropriating a sum of money to its payment).

⁴ *Boyd v. Conshohocken Worsted Mills*, 149 Pa. St. 363; 24 Atl. 287.

⁵ Cf. *Goodwin v. Hardy*, 57 Me. 143; 99 Am. Dec. 758; *Boardman v. Lake Shore, etc. Ry. Co.*, 84 N. Y. 157; *Zinn v. Germantown, etc. Mut. Ins. Co.* (Wisc.), 111 N. W. 1107 (as to dividends among members of a mutual insurance company).

⁶ *Hill v. Newichawanick Co.*, 8 Hun 459, affirmed short in 71 N. Y.

some fixed time in the future, payable at some time still further deferred. In such cases, it is submitted, the legal right to the dividend should vest in those persons who were holders of record, not when the resolution was passed nor when the dividend became payable, but at the time the company by its resolution fixed for determining the right thereto.¹ On the other hand, a corporation has no power to declare a dividend payable to those persons who were shareholders at some time prior to the passage of the resolution, and any dividend so declared will nevertheless be payable to all those persons who were shareholders at the time of the passage of the resolution.² Where the company transfers certain surplus earnings from the profit and loss account to an account to be known as the "addition and improvement account," and simultaneously issues bonds to its treasurer as trustee binding itself to pay to him at the expiration of ten years the amount so transferred from one account to another, which amount he was directed to pay to the persons who should then be shareholders, the entire transaction is a mere matter of book-keeping, and no dividend is deemed to be declared until the expiration of the ten years.³ The rule that the company may and must pay to the person who is the registered holder of the shares applies to cumulative preferred shares upon which dividends have been passed before the transfer.⁴

§ 1371. **Rights of Owner of legal Estate for Life in Shares.** — The owner of a legal life estate in shares, or an assignee of his interest, is entitled as against the company to collect any dividends which are declared during the estate for life, and may therefore

¹ Cf. *Burroughs v. North Carolina Iron Mfg. Co.*, 14 Gray (Mass.) R. R. Co., 67 N. Car. 376; 12 Am. 274.

Rep. 611; *Wheeler v. Northwestern Sleigh Co.*, 39 Fed. 347, 349 (semble).

But see *Hopper v. Sage*, 112 N. Y. 530; 20 N. E. 350; 8 Am. St. Rep. 771 (where the court refused to consider as material the date fixed by the resolution for the closing of the company's transfer books for the purpose of the dividend, but looked rather at the date of passage of the resolution).

² *Jones v. Terre Haute, etc. R. R. Co.*, 57 N. Y. 196.

But cf. *Johnson v. Bridgewater*

³ *Robertson v. De Brulatour*, 80 N. E. 938, 942-943; 188 N. Y. 301.

⁴ Cf. *Boardman v. Lake Shore, etc. Ry. Co.*, 84 N. Y. 157; *Jermain v. Lake Shore, etc. Ry. Co.*, 91 N. Y. 483; *Manning v. Quicksilver Mining Co.*, 24 Hun (N. Y.) 360.

But see *Bates v. Androscoggin, etc. R. R. Co.*, 49 Me. 491 (where the court apportioned the preferential dividend between the transferor and transferee).

sue the company at law to recover any such dividend.¹ The owner of a legal life estate — that is, a person who is registered as tenant for life of shares — is deemed the registered owner of the shares for the time being.

§ 1372. **Rights of Person to whom new Shares are issued.** — Moreover, when new shares are issued by a going concern, they are entitled to participate in all dividends declared after the issue, even though the profits out of which they are paid may have been earned prior to that time.²

§ 1373. **Forfeiture of Dividends.** — In a very peculiar Alabama case where the by-laws of a corporation provided that while any shareholder should be in default in regard to a duty owing to the company under its regulations he should forfeit the right to dividends, it was held that a delinquent shareholder forfeited so much of a dividend declared after his default had ceased as represented money earned by the company while he was in default.³ The case, however, fully recognizes the doctrine that ordinarily and *prima facie* dividends are not apportionable.

A more common case of forfeiture of dividends is the case where shares are forfeited. Of course, the consummated forfeiture disentitles the delinquent to any dividends subsequently earned. The effect of the forfeiture upon dividends which had been declared prior thereto is not so clear. One reason for the lack of authority upon this point is that any such dividends would usually be set off against the overdue calls so as to prevent a forfeiture.

§ 1374-§ 1398. *WHO ARE ENTITLED TO DIVIDENDS AS BETWEEN REGISTERED OWNER AND THIRD PERSONS.*

§ 1374. **In general — Trustee and Cestui Que Trust.** — Although as against the company the right to dividends is determined by the register of shareholders, yet the registered shareholder is by no means always entitled, as between himself

¹ *Ellis v. Proprietors of Essex* scrip convertible into shares, see *Merrimack Bridge*, 2 Pick. (Mass.) 243. *Brown v. Lehigh Coal, etc. Co.*, 49 Pa. St. 270.

² *Phelps v. Farmers', etc. Bank*, 26 Conn. 269; *Jones v. Terre Haute, etc. R. R. Co.*, 57 N. Y. 196 (bonds converted into stock under an option given to the holder).

³ *Bigbee, etc. Packet Co. v. Moore*, 121 Ala. 379; 25 So. 602.

As to the rights of holders of

and third persons, to retain the dividends for his own use.¹ For instance, to take the clearest case, a trustee of shares, whether upon an express trust or upon a constructive trust, is entitled to give a good acquittance to the company for any dividends payable in respect of the shares, but he is nevertheless bound to account for the dividends to the *cestui que trust*.

§ 1375. **As between Transferor and Transferee.** — As between transferor and transferee of shares, the right to dividends is of course a mere matter of mutual agreement.² The legal presumption is that the parties to a contract of sale of shares intend that all dividends and bonuses declared after the making of the contract, whenever the profits out of which they are declared may have been earned, shall belong to the transferee,³ and that

¹ "It is doubtless true that when a dividend is declared by a stock concern or corporation, it belongs, as between the corporation and the owners of the stock, to the person in whose name the stock then appears upon the stock book or lists of the corporation; but a stockholder may sell or transfer his shares of stock with or without gains or accrued dividends, and a dividend which has been declared may be made the subject of a contract, or a contract may be entered into regarding it, in the same manner and to the same extent, and as valid and binding as one in reference to any other kind of personal property." *Cook v. Monroe*, 45 Nebr. 349, 354; 63 N. W. 800. For illustrations. see *supra*, § 940.

² *Cook v. Monroe*, 45 Nebr. 349; 63 N. W. 800 (see particularly passage from opinion quoted in last preceding note); *Price v. Morning Star Mining Co.*, 83 Mo. App. 470; *Timberlake v. Shippers' Compress Co.*, 72 Miss. 323; 16 So. 530 (as to conflicting rights occasioned by reservations and transfers of future dividends); *Hancock v. Clark*, 68 Vt. 302 (stipulation that vendor should receive dividends on shares until payment of purchase money).

Cf. *Wheeler v. Northwestern Sleigh Co.*, 39 Fed. 347 (agent to sell stock

held to have no apparent authority upon which a purchaser is justified in relying to stipulate that the purchaser shall have a dividend declared before but payable after the purchase).

³ *Black v. Homersham*, 4 Ex. D. 24 (dividend declared after making of contract but before execution of transfer); *American Wire Nail Co. v. Gedge*, 96 Ky. 513; 29 S. W. 353; *Ryan v. Leavenworth, etc. Ry. Co.*, 21 Kans. 365; *March v. Eastern R. R. Co.*, 43 N. H. 515 (where the dividends were declared out of rental of the company's line of railway accruing prior to the transfer); *Coleman v. Columbia Oil Co.*, 51 Pa. St. 74 (dividend of stock which the company had purchased); *King v. Follet*, 3 Vt. 385; *Houser v. Richardson*, 90 Mo. App. 134, 141-142 (where the controversy was between a transferee whose transfer made no mention of future dividends and a person claiming under a subsequent transfer from the same transferor which did expressly include subsequent dividends); *Gemmell v. Davis*, 75 Md. 546, 552; 23 Atl. 1032; 32 Am. St. Rep. 412 (semble); *Corgan v. George F. Lee Coal Co. (Pa.)*, 67 Atl. 655; *March v. Eastern R. R. Co.*, 43 N. H. 515.

Cf. *Bryan v. Sturgis Nat. Bank*

all dividends and bonuses declared prior to that time, even though not payable until afterwards, shall go to the transferor.¹ Consequently, if the transfer is not forthwith presented for registration and the company accordingly pays subsequently declared dividends to the transferor, he must account for them to the transferee. The mere fact that the time for delivery and payment of the price is postponed, the purchaser paying interest, does not deprive the vendor of the right to dividends declared after the making of the contract of sale but before the shares are actually transferred.² But in the case of a mere option to buy shares, the purchaser by exercising the option does not become entitled to a dividend declared after the giving of the option but before the exercise thereof.³

Even an express reservation by the transferor of "all profits and dividends of and upon such stock" up to a certain date, will not be construed to enable the transferor to claim dividends declared after that date out of profits earned before that date.⁴ Moreover, a reservation of dividends up to a certain date after the transfer will be construed to extend only to such dividends as constitute income of the shares, and consequently a stock dividend declared after the transfer but before the date so fixed will go to the transferee.⁵ However, in a California case, where a contract for sale of shares made on September 22, contained

(Tex.), 90 S. W. 704 (as to rights of a trustee in bankruptcy).

¹ *Hill v. Newichiwanic Co.*, 8 Hun 459, affirmed short in 71 N. Y. 593 (where the resolution declaring the dividend left the time for payment to be fixed by an agent of the company and where the agent after the sale fixed a date accordingly); *Hopper v. Sage*, 112 N. Y. 530; 20 N. E. 350; 8 Am. St. Rep. 771 (where evidence of custom to the contrary was rejected); *Bright v. Lord*, 51 Ind. 272; 19 Am. Rep. 732; *Redhead v. Iowa Nat. Bank*, 127 Iowa 572; 103 N. W. 796; *Wheeler v. Northwestern Sleigh Co.*, 39 Fed. 347.

But see *Burroughs v. North Carolina R. R. Co.*, 67 N. Car. 376; 12 Am. Rep. 611 (where the resolution declaring the dividend provided that

the transfer books should be closed for a month prior to the time when it was made payable).

The rule is the same where the transfer is intended as collateral security for a debt. *Fairbank v. Merchants' Nat. Bank*, 132 Ill. 120; 22 N. E. 524. Cf. *infra*, § 1376.

² *Currie v. White*, 45 N. Y. 822.

³ *Bright v. Lord*, 51 Ind. 272; 19 Am. Rep. 732; *Clark v. Campbell* (Utah), 65 Pac. 496.

But see *contra*: *Harris v. Stevens*, 7 N. H. 454.

Cf. *Rowe v. White*, 112 N. Y. App. Div. 688; 98 N. Y. Supp. 729.

⁴ *Hyatt v. Allen*, 56 N. Y. 553; 15 Am. Rep. 449.

⁵ *Kaufman v. Charlottesville Woolen Mills*, 93 Va. 673; 25 S. E. 1003.

a provision that the purchaser should have "all dividends made after the morning of the twenty-third of September," the court admitted parol evidence to show that both parties expected a dividend to be declared on September 22, which was not actually declared until the afternoon of the twenty-third, and upon this evidence held that the transferor was entitled to the dividend;¹ but except for the fact that the transferee had been guilty of a fraud by requesting the officers of the company to postpone the declaration of the dividend, one would be tempted to question the decision.

The right of the transferee to all dividends declared after the contract of transfer extends even to preferential dividends which ought to have been, but were not, declared before the transfer.²

§ 1376. **As between Pledgor and Pledgee or Mortgagor and Mortgagee.** — The right to dividends as between a debtor and a creditor to whom shares are transferred as collateral security has been considered above.³ It is here necessary only to add that in the absence of special agreement a transfer of shares as collateral security can give the creditor no right to dividends or bonuses declared prior to the hypothecation.⁴

§ 1377-§ 1396. **AS BETWEEN TENANTS FOR LIFE AND
REMAINDERMEN.**

§ 1377. **Ordinary periodic Dividends.** — The right to dividends as between tenants for life and remaindermen is a very complex subject. As regards ordinary periodic dividends the rule as accepted by the great weight of authority is simple enough: all dividends declared after the commencement of the life estate by deed or otherwise, and before the death of the life tenant are deemed income and belong to the tenant for life.⁵

¹ *Brewster v. Lathrop*, 15 Cal. 21.

² *Jermain v. Lake Shore, etc. Ry. Co.*, 91 N. Y. 483; *Boardman v. Lake Shore, etc. Ry. Co.*, 84 N. Y. 157; *Manning v. Quicksilver Mining Co.*, 24 Hun (N. Y.) 360.

But see *Bates v. Androscoggin, etc. R. R. Co.*, 49 Me. 491.

³ *Supra*, § 995-§ 1005.

⁴ *Fairbank v. Merchants' Nat. Bank*, 132 Ill. 120; 22 N. E. 524.

⁵ As to a case of a trust for conversion where the trustees temporarily retain shares which are not authorized as investments, see *Chaytor v. Horn* (1905), 1 Ch. 233; *Bulkeley v. Stephens*, 10 L. T. 225; *Brown v. Gellatly*, 2 Ch. 751; *Lewin on Trusts*, 11th ed. 334-336; 2 *Perry on Trusts*, 5th ed. 548. Cf. *Re James*, 146 N. Y. 78; 40 N. E. 876; 48 Am. St. Rep. 774.

This rule is irrespective of the time when the profits which justify the dividend were earned — whether before the creation of the estate for life or afterwards.¹ Conversely, all dividends declared before the testator's death even though not payable until afterwards should go into the residue of the estate and not to the tenant for life.² And all dividends declared after the determination of the estate for life go to the remainderman without any apportionment.³

§ 1378-§ 1391. *Extraordinary Dividends and Bonuses.*

§ 1378. **Intention of Testator or Settlor as the Criterion.** — Difficulties arise when a corporation which has been pursuing the policy of accumulating a surplus suddenly reverses its policy and declares a dividend, payable either in cash or in stock, out of the accumulated fund. Of course, the question depends upon the intention of the testator or settlor.⁴ That is to say, it is competent to him to direct that extraordinary dividends or bonuses, whether payable in money or in shares of the company's capital stock shall go to the tenant for life as his own or shall

¹ *Bates v. Mackinley*, 31 Beav. 280; *Re Kernochan*, 104 N. Y. 618, 626-630; 11 N. E. 149; *Earp's Appeal*, 28 Pa. St. 368, 375 (semble); *Earp's Will*, 1 Pars. Eq. (Pa.), 453, 465 (headnote inadequate).

But see *Lang v. Lang*, 57 N. J. Eq. 325, 328; 41 Atl. 705. See also *infra*, § 1388.

² *Wright v. Tuckett*, 1 J. & H. 266; *Re Kernochan*, 104 N. Y. 618; 11 N. E. 149.

But see *Clive v. Clive*, Kay 600 (depending upon peculiar provisions of the company's deed of settlement).

³ *Clapp v. Astor* (N. Y.) 2 Edw. Ch. 379; *Foote Appellant*, 22 Pick. (Mass.) 299; *Mann v. Anderson*, 106 Ga. 818; 52 S. E. 870 (where the dividend was declared by a railway company out of rental received by virtue of a lease of its line); *Re Kane*, 64 N. Y. App. Div. 566; 72 N. Y. Supp. 333.

But see *Johnson v. Bridgewater*

Iron Mfg. Co., 14 Gray (Mass.) 274 (where a dividend declared after the death of the tenant for life out of profits earned during her life was awarded to her executor — *sed quære*); *Ex parte Rutledge*, 1 Harp. Eq. (S. Car.) 65; 14 Am. Dec. 696 (where the dividend was apportioned).

⁴ Cf. *Green v. Bissell* (Conn.), 65 Atl. 1056 (where the will as construed by the court provided for annual distributions of income, so that the estate of a tenant for life would not be entitled to income received by the trustees prior to the life tenant's death but not distributable until afterwards); *Re Robinson's Trust* (Pa.), 67 Atl. 775 (where the deed creating the trust provided that any "dividends whether in money or scrip of any description" should go to the tenant for life).

As to a case where the shares are not an authorized investment, see *supra*, p. 1136, n. 5.

go into the corpus of the estate. Unfortunately, however, testators rarely foresee this question and therefore rarely make explicit provision for these contingencies. The question, therefore, in most cases must be decided according to the legal presumptions as to the testator's intentions. Indeed, the courts while always recognizing that the intention of the testator is controlling, are not inclined to be swayed by minute peculiarities in his language which more probably than not had no reference to this problem.¹ But inasmuch as the question what is to be deemed income under a deed or will is always in the last analysis dependent on the intention of the testator or settlor, it follows that the question is to be determined by the law of the state which governs the construction of the deed or will, rather than by the law of the state under whose laws the corporation was formed.²

§ 1379. **The English Doctrine.** — *A Power deemed to be vested in Company to determine whether Distribution shall be made as Income for Tenant for Life or as Capital for Benefit of Remaindermen.* — According to the English doctrine as finally settled by the House of Lords in 1887, after vacillating and confusing decisions in the lower courts and even in the House of Lords itself, the law is that where shares are settled by deed or will for the benefit of one person for life with remainder over, the testator or settlor is deemed to confer upon the company a power to determine whether money, or property, distributable among the shareholders is to be deemed income or capital. The rule is thus expressed by Lord Justice Fry in language which was quoted with approval by the House of Lords, "When a testator or settlor directs or permits the subject of his disposition to remain as shares or stocks in a company which has the power either of distributing its profits as dividends or of converting them into capital and the company validly exercises this power, such exercise of the power is binding on all persons interested under the testator or settlor in the shares, and consequently what is paid by the company as dividend goes to the tenant for life and what

¹ Cf. *Brinley v. Grou*, 50 Conn. 66; 47 Am. Rep. 618 (where a direction that the tenant for life should have the "rents, dividends, increase and income" of the fund was held to mean no more than that he should have the income thereof).
² *Mercer v. Buchanan*, 132 Fed. 501, 502-503 (headnote inadequate).

is paid by the company to the shareholders as capital, or appropriated as an increase of the capital stock in the concern, enures to the benefit of all who are interested in the capital.”¹

§ 1380. *Application of Principle to “Stock Dividends” — Dividends payable in Shares or accompanied by an Offer of new Shares to the old Shareholders pro rata.* — The application of this rule is not, however, free from difficulty; for it is not always easy to decide how the corporation should be taken to have exercised the power deemed to be vested in it. The rule would seem unavoidably to lead to the result that “stock-dividends” are necessarily capital and not income as between tenant for life and remainderman.² For in making a “stock-dividend,” thereby increasing the legal or nominal capital, the company is formally capitalizing its earnings. So, where the company declared an extraordinary cash dividend but accompanied it with an offer of new shares to the old shareholders *pro rata*, the amount of the cash dividend to be retained by the company and credited as paid on the new shares, the court regarded the transaction as virtually equivalent to an extraordinary dividend declared out of accumulated profits and payable in shares, and accordingly regarded the new shares as corpus of any trust estate which was the owner of old shares.³ Lord Herschell was of opinion that the several shareholders might have elected to take the cash dividend and refuse the shares⁴ but Lord Watson was “satisfied that in the present case no such option was given by the company.”⁵ In a later case before Stirling, J., where the facts were somewhat similar but where the intention to give the several shareholders an option of taking the cash dividend or of subscribing to the new shares, was very clear, the learned judge came to the conclusion that the cash dividend was severable from the offer of the new shares, and that the company did not intend to capitalize its earnings; for these reasons, he held that

¹ *Bouch v. Sproule*, 12 A. C. 385, 397-398; *Re Barton's Trust*, 5 Eq. 238 (approved by the House of Lords in *Bouch v. Sproule*, supra).

² Cf. *Bouch v. Sproule*, 12 A. C. 385, 405 (where Lord Watson said: “If I am right in my conclusion the substantial bonus which was meant to be given to each shareholder was not a money payment but a propor-

tional share of the increased capital of the company. In that view of the case it does not admit of doubt that the benefit must accrue to the remainderman and not the tenant for life”).

³ *Bouch v. Sproule*, 12 A. C. 385.

⁴ 12 A. C. 398.

⁵ 12 A. C. 404.

where trustees elected to take the new shares, an amount equivalent to the offered cash dividend should be paid to the tenant for life, and all the residue of the amount realized from a sale of the new shares should go into the corpus of the estate.¹

§ 1381. *Extraordinary Cash Dividends.* — Where an extraordinary cash dividend is declared, the English rule leads to the question whether a corporation is deemed to convert its profits into capital by accumulating them and using them as part of its *de facto* or working capital so that any dividend subsequently declared out of those profits should be treated as having been paid by the corporation as capital. On principle, it would seem clear that this should not be so. Profits do not become capital by being used as capital. They can only be capitalized by increasing the legal or nominal capital. In England, however, the matter is complicated by a line of British cases, beginning with a decision of Lord Rosslyn, in which extraordinary cash dividends were treated, as between tenant for life and remainderman, as increments to capital.² In *Bouch v. Sproule*, the ruling case on the subject in the House of Lords, the several members of that tribunal seemed to have differed somewhat in opinion. Lord Bramwell, rejecting the earlier British cases as “very unsatisfactory” and stating that he “could deduce no principle from them,” seems to have thought that all cash dividends are properly income payable to the tenant for life, even though the profits out of which they are declared may have been earned before the testator’s death and may have become *de facto* part of the company’s actual, working capital.³ On the other hand Lord Herschell, with whom

¹ *Malam v. Hitchens* (1894), 3 Ch. 578. See *Ellis v. Barfield*, W. N. (1891) 84; *Re Northage* (1891), 60 L. J. Ch. 488; and *Davis v. Jackson*, 152 Mass. 58; 25 N. E. 21; 23 Am. St. Rep. 801 (stated *infra*, § 1386), to substantially the same effect.

² See *infra*, p. 1141, n. 1.

³ *Bouch v. Sproule*, 12 A. C. 385, 405–406, where Lord Bramwell said:

“A sole trader with a capital of £10,000 who makes in a year a profit of £2000 and spends £1000 only, leaving the other £1000 in his business, may well in the next year be

said to have a capital of £11,000; not so where there is a partnership, whether an ordinary partnership or an incorporated partnership. There the undivided profits of any period, a year or shorter or longer time, continue to be undivided profits unless something in the articles of partnership or some agreement by all the partners makes them capital. They do not become capital by effluxion of time or by their being used in the trading.

“For example, a company makes a profit of £10,500 in a year. Sup-

Lord Watson seems to have concurred, approved the earlier cases in which extraordinary cash dividends declared out of accumulated profits which had been retained and used by the company as a reserve fund or part of its actual capital were treated as accretions to principal rather than income,¹ and he distinguished those cases on the ground that the companies to which they related had no power to increase their nominal capital, which in each case was fixed by act of Parliament.² The doctrine seems to have been accepted by all the Lords who participated in the decision that in the case of a company which is incorporated under the Companies Act of 1862

pose its capital to be £200,000, it divides the £10,000 giving 5 per cent to its shareholders; trading with the £500 as its other funds. It does this four years with the same result of profit and dividend. At the end of the fourth year its undivided profits, including those brought forward, are £12,000, and it can and does pay 6 per cent to its shareholders. Can there be a doubt of its right to do so? Is it not the fair and just thing as between a tenant for life and remainderman. I say yes, and if true for four years it is true for forty." Note, however, that Lord Bramwell expressed his concurrence with Lord Herschell and Lord Watson "in their reasoning and their view of the authorities" (12 A. C. 407).

¹ *Brander v. Brander*, 4 Ves. 800 (where the dividend was payable in assets of the bank in kind, and where Lord Rosslyn said (p. 802), "It would be a neater way to convert it into Bank Stock. They could not do that without an Act of Parliament."); *Irving v. Houstoun*, 4 Paton Sc. App. 521 (Lord Eldon participating in the decision and delivering the leading opinion with apparent heartiness); *Paris v. Paris*, 10 Ves. 185 (where Lord Eldon followed but disapproved the earlier decisions); *Clayton v. Gresham*, 10 Ves. 288; *Witts v. Steere*, 13 Ves. 363;

Ward v. Comb, 7 Sim. 634; *Ex parte Hodgins* (1847), 11 Ir. Eq. 99; *Plumbe v. Neild*, 29 L. J. Ch. 618 (semble); *Hooper v. Rossiter*, McCl. 527 (a case of a "stock dividend" authorized by Act of Parliament increasing the capital of the Bank of England); *Nicholson v. Nicholson*, 30 L. J. Ch. 617 (where the distribution of a surplus was part of an amalgamation scheme); *Straker v. Wilson*, 6 Ch. 503 (a case relating to profits of a mere unincorporated partnership).

For cases prior to *Bouch v. Sproule* where special or increased dividends were awarded to tenants for life, see *Barclay v. Wainwright*, 14 Ves. 66; *Preston v. Melville*, 16 Sim. 163; *Price v. Anderson*, 15 Sim. 473; *Plumbe v. Neild*, 29 L. J. Ch. 618 (where a "bonus" was declared out of profits earned during the current half-year); *Hollis v. Allan*, 14 W. R. 980 (dividend declared by a company which were acting as their own insurers, out of a surplus on the insurance fund); *Maclaren v. Stainton*, 3 DeG. F. & J. 202 (where an extraordinary dividend was declared out of funds unexpectedly recovered from the estate of the company's former manager); *Re Hopkins Trusts*, 18 Eq. 696; *Dale v. Hayes*, 40 L. J. Ch. 244.

² *Bouch v. Sproule*, 12 A. C. 385, 397, 401.

and which has power to increase its legal or nominal capital by going through the statutory formalities, the fact that the company may have used accumulated profits as part of its *de facto* capital will not amount to a capitalization of them unless the capital is increased in the legal mode, and that consequently any cash dividend, however large and however extraordinary, and no matter how long a period the profits out of which it is declared may have been accumulating, is to be deemed income payable to the tenant for life.¹ To quote Lord Herschell's own words, "Where a company has power to increase its capital and to appropriate its profits to such increase, it cannot be considered as having intended to convert, or as having converted, any part of its profits into capital when it has made no such increase, even if a company having no power to increase its capital may be regarded as having thus converted profits into capital by the accumulation and use of them as such."² The reason for this distinction in the case of companies which have no power to increase their capital is not easily discerned; and indeed one cannot but feel that the learned lords took the distinction merely because they felt themselves bound by the earlier decisions and particularly by the decision of their own House in *Irving v. Houstoun*.³ Had they been unfettered by precedent, they would probably have applied to companies which have no power to increase their nominal capital the same doctrine which they laid down as applicable to companies which possess that power. At any rate, almost all companies incorporated under general laws have power to increase their nominal capital; and as to companies which have that power the doctrine of the House of Lords is clear and simple — that all cash dividends declared during the running of the estate for life go to the tenant for life as income.

In a recent Australian case relating to dividends declared by an unincorporated company, the judge, notwithstanding *Bouch v. Sproule* by which of course he was bound, felt justified in treating an extraordinary cash dividend as corpus rather than income.⁴ The case of a mere voluntary company⁵ is doubtless

¹ Accord: *Sugden v. Alsbury*, 45 Ch. D. 237.

² *Bouch v. Sproule*, 12 A. C. 385, 398.

³ *Irving v. Houstoun*, 4 Paton Sc. App. 521.

⁴ *Reid v. Silke*, 31 Vict. L. R. 641.

⁵ Cf. *D'Ooge v. Leeds*, 176 Mass.

distinguishable from that of a corporation whose capital is limited by statute to the amount named in its incorporation paper unless it be increased by pursuing the statutory method of increasing it.

§ 1382. *Sums distributed to Shareholders nominally in Reduction of Capital but without legal Reduction.* — As, according to the doctrine of *Bouch v. Sproule*, all payments made by a corporation to its shareholders out of profits are to be treated as income payable to a tenant for life of the shares unless the profits have been validly capitalized, it follows that profits distributed to the shareholders, with the understanding that the amounts so distributed shall go in reduction of the paid-up capital, must nevertheless go to the tenant for life unless valid proceedings for reduction of the capital are had.¹

§ 1383. **Massachusetts Doctrine that Cash Dividends are Income for Tenant for Life and Stock Dividends Corpus for Remaindermen** — *In general.* — In America, the courts were much embarrassed by the line of earlier English cases beginning with Lord Rosslyn's decision in *Brander v. Brander*,² which ultimately were very closely limited if not overruled by the House of Lords in *Bouch v. Sproule*. Notwithstanding those cases, many American courts, under the leadership of the Supreme Judicial Court of Massachusetts, some anticipating and some following the decision of the House of Lords, have held that cash dividends, however large or unusual and whenever the profits out of which they are payable may have been earned, go to the tenant for life as income, if the declaration of the dividends took place while the estate for life was running.³ The same law applies where an

558; 57 N. E. 1025 (stated *infra*, p. 1145, n. 4).

¹ *Whitwham v. Piercy* (1907), 1 Ch. 289. Cf. *infra*, § 1395.

² *Brander v. Brander*, 4 Ves. 800.

³ *DeKoven v. Alsop*, 205 Ill. 309, 310-311; 68 N. E. 930; 63 L. R. A. 587; *Waterman v. Alden*, 42 Ill. App. 294 (affirmed as to this point in 144 Ill. 90, 99); *Harvard College v. Armory*, 9 Pick. (Mass.) 446 (dividends declared by a marine insurance company out of funds realized from a foreign government on account of illegal captures of insured property,

and by a manufacturing company out of proceeds of sale of patent rights); *Leland v. Hayden*, 102 Mass. 542; *Re Kernochan*, 104 N. Y. 618, 626-630; 11 N. E. 149; (But see as to New York rule, *infra* § 1390); *Warren's Estate*, 11 N. Y. Supp. 787 (stated *infra*, § 1392); *Richardson v. Richardson*, 75 Me. 570; 46 Am. Rep. 428 (a well-reasoned case with which, however, *Gilkey v. Paine*, 80 Me. 319; 14 Atl. 205, stated *infra*, § 1385, should be compared); *Mil-len v. Guerrard*, 67 Ga. 284; 44 Am. Rep. 720; *Mills v. Britton*, 64 Conn.

extraordinary cash dividend is declared in pursuance of an agreement whereby all the shareholders are to sell their shares with a proviso that certain assets belonging to the company shall be converted into cash and in that form distributed among the vendor shareholders.¹ This view seems identical with the doctrine of *Bouch v. Sproule* except that the curious exception which the House of Lords were obliged to make in order to distinguish the earlier British cases is not recognized.² In other words, the same rule applies whether the company has or has not power to capitalize its earnings by increasing its nominal capital: in either event all cash dividends and bonuses declared during the pendency of the life estate go to the tenant for life.

Most of the courts which adopt this view, including such eminent tribunals as the Supreme Court of the United States and the Supreme Courts of Massachusetts and Illinois, adhere to the converse proposition, to-wit, that all stock dividends go into the corpus.³ *A fortiori* a stock dividend declared out of a sum realized from supposedly worthless assets which had been written off by a reduction of capital, goes into the corpus of the estate.⁴ Moreover, where cumulative eight per cent preferred shares are surrendered in exchange for twice the number of non-cumulative four per cent preferred shares, one of the motives of the exchange being to effect a settlement for arrears of the

4, 12; 29 Atl. 231; 24 L. R. A. 536; (semble); *Smith v. Dana*, 77 Conn. 543; 60 Atl. 117; 69 L. R. A. 76; 107 Am. St. Rep. 51 (a careful, exhaustive and convincing opinion); *Boardman v. Boardman*, 78 Conn. 451; 62 Atl. 339.

Cf. *Re James*, 146 N. Y. 78; 40 N. E. 876; 48 Am. St. Rep. 774.

¹ *Hemenway v. Hemenway*, 181 Mass. 406; 63 N. E. 919.

But see contra as to the same transaction; *Second Universalist Church v. Colegrove*, 74 Conn. 79; 49 Atl. 902.

² Cf. *D'Ooge v. Leeds*, 176 Mass. 558; 57 N. E. 1025, as to an unincorporated association which apparently might increase its capital indefinitely by mere agreement of the members.

³ *Minot v. Paine*, 99 Mass. 101; 96 Am. Dec. 705; *Gibbons v. Mahon*, 136 U. S. 549; 10 Sup. Ct. 1057 (a very able opinion containing review of the authorities); *Re Brown and Larned*, 14 R. I. 371; 51 Am. Rep. 397; *Spooner v. Phillips*, 62 Conn. 62; *Mills v. Britton*, 64 Conn. 4, 12; 29 Atl. 231; 24 L. R. A. 536; *DeKoven v. Alsop*, 205 Ill. 309, 312-319; 68 N. E. 930; 63 L. R. A. 587; *Blinn v. Gillett*, 208 Ill. 473.

Cf. *Kaufman v. Charlottesville Woolen Mills*, 93 Va. 673; 25 S. E. 1003; *Hotchkiss v. Brainerd Quarry Co.*, 58 Conn. 120; 19 Atl. 521 (where a partnership in which a widow had a life interest was converted into a corporation).

⁴ *Peckham v. Mason*, 8 R. I. 427.

cumulative preferential dividend, all the new shares which are issued to a trust estate must be treated by the trustees as corpus and not income.¹

§ 1384. *Dividends paid in Property, in Scrip, etc. assimilated to Cash Dividends.* — Dividends declared payable in property instead of cash are for purposes of this rule assimilated to cash dividends rather than to stock dividends.² As Lord Eldon said, "As to the distinction between stock," — meaning government stock owned by the company and not shares in the capital of the company itself — "and money, that is too thin."³ The same rule would apply to dividends payable in property, bonds, scrip certificates of indebtedness, or anything except shares of capital stock.⁴

§ 1385. *Dividends paid in Shares which have been once issued and afterwards acquired by the Company.* — Indeed, it has been held in Massachusetts that dividends declared in stock which had been previously issued and purchased by the company are for this purpose regarded as dividends payable in property, and not as stock dividends properly so-called, and therefore go to the tenant for life as income;⁵ but the Supreme Court of Maine, distinguishing the Massachusetts case on the ground that there the purchase had been made by the company with accumulated profits, held that, where the shares were bought by the company with capital, the distribution should be treated by trustees of some of the other shares as capital and not income.⁶ The decision of the court in the Maine case, however unfortunate some of its *dicta* may be regarded, would seem to be beyond criticism; and indeed one may be permitted to doubt whether the Massachusetts doctrine, even when confined to

¹ *Mills v. Britton*, 64 Conn. 4; 29 Atl. 231; 24 L. R. A. 536.

² *Millen v. Guerrard*, 67 Ga. 284; 44 Am. Rep. 720; *Green v. Bissell* (Conn.), 65 Atl. 1056.

³ *Paris v. Paris*, 10 Ves. 185, 190. Note that this statement of Lord Eldon has often been misunderstood. See e. g., *infra*, § 1387.

⁴ *Waterman v. Alden*, 42 Ill. App. 294, 319 (affirmed as to this point in 144 Ill. 90, 99).

But see *D'Ooge v. Leeds*, 176 Mass.

558; 57 N. E. 1025 (where a dividend payable in "bonds" which contained no binding contract to pay anything, but rather resembled preferred stock, was, in the case of a voluntary association, treated, like a stock dividend, as corpus).

⁵ *Leland v. Hayden*, 102 Mass. 542.

⁶ *Gilkey v. Paine*, 80 Maine 319; 14 Atl. 205, approved and followed in *Pabst v. Goodrich* (Wisc.), 113 N. W. 398.

cases where the company had purchased the shares with capital moneys, can be regarded as sound. Why should the case where the stock dividend is made with stock which has previously been issued and which the company has bought in be different from a case where the stock which is used for the stock dividend is then issued for the first time? The Supreme Court of Connecticut, however, has followed the Massachusetts decision in a case where the dividend was declared with shares which had been accepted in payment of a debt.¹

§ 1386. *Cash dividends accompanied by an Offer of new Shares to the old Shareholders pro rata.* — As to cases where a corporation declares a cash dividend and simultaneously offers to the existing shareholders an option of subscribing to new shares, the cash dividend in the event of an exercise of the option to be retained by the company and credited on the new shares, the American courts which adhere to the modern English rule experience the same difficulty as we have seen that the English courts have encountered. In such a case, an Illinois court, while expressly and emphatically approving the doctrine laid down by the House of Lords in *Bouch v. Sproule*, nevertheless held that the new shares, which the trustees elected to take in lieu of the cash dividend, ought to go to the tenant for life.² On the other hand, the Massachusetts Court, in a case where the offer of a cash dividend was obviously a mere form, the clear intent being to declare in substance a stock dividend, held that the new shares were corpus and not income;³ and similarly where the new shares are offered to the old shareholders at par, with a provision that the amount so realized, or realized by sale to the public of such of the new shares as the old shareholders may refuse to take, shall be distributed as a cash dividend, the transaction is regarded as amounting in substance to a stock dividend, so that whether the new shares be taken by the trust estate or whether the trustees elect to let them be sold to the public and to take the proceeds in cash, in either event the transaction must enure to the benefit of the corpus of the trust estate, the shares

¹ *Green v. Bissell* (Conn.), 65 Atl. 1056.

³ *Rand v. Hubbell*, 115 Mass. 461; 15 Am. Rep. 121; *Deland v. Wil-*

² *Waterman v. Alden*, 42 Ill. App.

Wiams, 101 Mass. 571.

294 (affirmed as to this point although reversed as to others in 144 Ill. 90, 99). Cf. *Hyde v. Holmes* (Mass.), 84 N. E. 318.

or cash, as the case may be, being principal and not income.¹ If the shareholders are to have a real option of taking the cash dividend and of selling their right to subscribe to the new shares, trustees who elect to take the shares in lieu of the cash dividend must turn over to the tenant for life so much of the new shares as represent the cash dividend, and will hold the residue only as corpus of the estate.²

§ 1387. **Pennsylvania Doctrine of Apportionment** — *In general* — It might have been expected that some American courts before the decision in *Bouch v. Sproule* should have adopted the doctrine of *Brander v. Brander*, if indeed that unfortunate decision can be said to represent any doctrine beyond the doctrine that each case is to be decided according to the length of the chancellor's foot. But few, if any, American courts fell into that error. The tendency seems rather to have been to reject *Brander v. Brander* with such emphasis that some courts, without hitting upon the simple rule that was afterwards adopted by the House of Lords and the Supreme Courts of Massachusetts and of the United States, in avoiding the Scylla of *Brander v. Brander* fell into the clutches of a Charybdis. These courts, sensible of the wholly unsatisfactory state of the law represented by *Brander v. Brander* and the other early English cases, adopted the view that all extraordinary dividends, whether payable in cash or in new shares of the company, shall be apportioned between tenant for life and remainderman according to the time when the profits out of which they are declared were earned. This doctrine was first laid down by the Supreme Court of Pennsylvania in 1857 in the leading case of *Earp's Appeal*,³

¹ *Leland v. Hayden*, 102 Mass. 542.

² *Davis v. Jackson*, 152 Mass. 58 (headnote misleading); 25 N. E. 21; 23 Am. St. Rep. 801; *Lyman v. Pratt*, 183 Mass. 58.

Cf. *Malam v. Hitchens* (1904), 3 Ch. 578 (stated supra, § 1380) to substantially the same effect as *Davis v. Jackson*, ubi supra.

³ *Earp's Appeal*, 28 Pa. St. 368. Followed in *Smith's Estate*, 140 Pa. St. 344; 21 Atl. 438; 23 Am. St. Rep. 237; *Philadelphia Trust, etc. Co's Appeal* (Pa.) 24 Wkly. Notes Cas. 137; 16 Atl. 734 (dividend pay-

able in bonds convertible into stock at company's option awarded to life-tenant as income); *Turpin's Estate*, 21 Wkly. Notes Cas. (Pa.) 542 (same point as last case).

See also *Willbank's Appeal*, 64 Pa. St. 256; 3 Am. Rep. 585.

Cf. *Ex parte Rutledge*, 1 Harp. Eq. (S. Car.) 65; 14 Am. Dec. 696; where as early as 1824 Chancellor Waties of South Carolina apportioned a dividend between a remainderman and the representative of a tenant for life, his decree being affirmed by the Court of Appeals.

where the court held that so much of a stock dividend as represented profits earned before a testator's death should be treated as corpus while so much of the same dividend as represented profits earned after his death should go as income to the tenant for life under his will.

Pausing only to remark that the learned court was mistaken in supposing that Lord Eldon in *Paris v. Paris*,¹ had repudiated the distinction between a cash dividend and a dividend payable in shares of increased capital stock of the company itself, inasmuch as the distinction which Lord Eldon repudiated was the attempted distinction between a cash dividend and a dividend payable in assets in kind — that is, a dividend payable in government stock, and not a dividend in the capital stock of the company itself,² — we may observe that this rule of the Pennsylvania Court, although revolutionary in its departure from previously established principles to the non-apportionability of dividends, would be just and equitable, provided only it were always possible to ascertain with even an approach to accuracy when the profits out of which a dividend is declared were earned. In *Earp's Appeal*, the court used the market value of the shares as a criterion — a most uncertain guide. In later cases, the same learned court held that market value was of evidential importance only, and that the "intrinsic value" was the true standard; but no rule for ascertaining the intrinsic value was suggested,³ and one of the lower courts of the same state in a recent case seems to have held that the tenant for life is *prima facie* entitled to the whole of any dividend paid during his time, the remainderman being entitled to so much only as he can prove to have been paid with profits earned before the testator's death.⁴ The New Jersey Court of Errors after adopting the rule of apportionment felt obliged to assist themselves by creating a presumption that "earnings have been made uniformly, day by day, since the last similar dividend was

¹ *Paris v. Paris*, 10 Ves. 185.

² *Supra*, § 1384.

³ *Smith's Estate*, 140 Pa. St. 344; 21 Atl. 438; 23 Am. St. Rep. 237.

Cf. *Oliver's Estate*, 136 Pa. St. 43, 61; 20 Atl. 527; 20 Am. St. Rep. 894; 9 L. R. A. 421 (where a one thousandfold increase in value of

lands belonging to the company by the discovery of mineral deposits therein after the testator's death was held to be profits earned after the death of the testator and therefore distributable to the life tenant).

⁴ *Crosman's Estate*, 14 Pa. Dist. Rep. 40 (headnote inadequate).

declared.”¹ The suggestion has been repudiated that where at the time of the declaration the company has on hand profits earned at various periods, the dividend should be taken as declared out of the earliest earnings.²

§ 1388. *Whether Rule of Apportionment extends to ordinary periodic Dividends.* — It should be observed that this rule of apportioning dividends applies in Pennsylvania only to extraordinary dividends and does not disturb the rule that ordinary dividends are not apportionable;³ but on the other hand, the New Jersey courts, which have approved the doctrine of apportionment, apply it to ordinary as well as to extraordinary dividends.⁴ Certainly, if a court is going to break into the doctrine that dividends are not apportionable, there would seem to be as strong a reason for apportioning ordinary periodic dividends as for apportioning extraordinary bonuses. The only reason for making a distinction is that in the case of an extraordinary bonus, the apparent hardship of refusing an apportionment is the greater.

§ 1389. *Miscellaneous cases adopting Pennsylvania rule.* — In the midst of the confusion of the early English cases, and before the air was cleared, first by the decisions of the Supreme Court of Massachusetts and ultimately by the decision of the House of Lords in *Bouch v. Sproule*, where that tribunal reasoned out as a principle the same doctrine which the Supreme Court of Massachusetts had laid down as an almost arbitrary working rule, it is not surprising that many courts should adopt the fair-seeming rule of the Pennsylvania Court. Accordingly, that rule was expressly adopted by Chancellor Zabriskie of New Jersey in 1868,⁵ and by the Supreme Court of New

¹ *Lang v. Lang*, 57 N. J. Eq. 325, 329; 41 Atl. 705.

² *Lang v. Lang*, 57 N. J. Eq. 325; 41 Atl. 705.

³ *Earp's Appeal*, 28 Pa. St. 368, 375. Cf. *McKeen's Appeal*, 42 Pa. St. 479, 485; *Earp's Will*, 1 Pars. Eq. (Pa.) 453, 465 (headnote inadequate).

⁴ *Lang v. Lang*, 57 N. J. Eq. 325, 328; 41 Atl. 705 (semble).

⁵ *Van Doren v. Olden*, 19 N. J. Eq. 176 (stock dividends apportioned).

Cf. *Ashurst v. Field*, 26 N. J. Eq.

1 (stock dividends awarded to life tenant); *Pratt v. Douglas*, 38 N. J. Eq. 516, 541 (headnote inadequate); *Brown v. Brown* (N. J.), 65 Atl. 739, 743 (shares allotted in pursuance of option to apply simultaneous cash dividend in payment for new shares offered *pro rata* to the old shareholders, apportioned — headnote inadequate); *Lang v. Lang*, 57 N. J. Eq. 325; 41 Atl. 705 (cash dividend apportioned).

Hampshire in 1872,¹ by the Supreme Court of Tennessee in 1895² and apparently by the Court of Appeals of Maryland in 1894,³ although a later Maryland case closely limits if it does not virtually overrule this decision.⁴

§ 1390. **New York Doctrine — Miscellaneous American Cases.** — It is, however, surprising to find that so late as 1897 so distinguished a tribunal as the Court of Appeals of New York, in awarding to a tenant for life a stock dividend declared out of profits earned during the estate for life, should not merely approve the doctrine of the Pennsylvania decisions (in spite of the fact that an earlier decision of the New York Court of Appeals itself was in conflict with the Pennsylvania rule of apportionment) and disapprove the Massachusetts cases, but should fall into the patent error of asserting that the Massachusetts rule is the same as that laid down by the early English cases such as *Brander v. Brander* and *Paris v. Paris*.⁵ Moreover, it is most remarkable that, although both counsel and court cite the decision of the English Court of Appeal in *Bouch v. Sproule*, yet both seem to have been ignorant of the fact that the decision cited had been

¹ *Lord v. Brooks*, 52 N. H. 72, where the adoption of the Pennsylvania rule was not in strictness necessary to the decision, as the case related to distribution in liquidation proceedings of profits which had been accumulated during the running of the estate for life. See *infra*, § 1394. Note also that the court on motion for rehearing suggested various modifications of the simple Pennsylvania rule as adopted in the original opinion, which it will be observed expressly disapproved the Massachusetts cases). See *Holbrook v. Holbrook* (N. H.), 66 Atl. 124 (extraordinary dividends, whether payable in stock or in cash, apportionable), overruling *Quinn v. Madigan*, 65 N. H. 8; 17 Atl. 976.

² *Pritchett v. Nashville Trust Co.*, 96 Tenn. 472; 36 S. W. 1064; 33 L. R. A. 856 (life tenant awarded stock dividends declared from profits earned after creation of life estate, but Pa. doctrine of apportionment expressly approved).

³ *Thomas v. Gregg*, 78 Md. 545; 28 Atl. 565; 44 Am. St. Rep. 310.

⁴ *Quinn v. Safe Deposit & Trust Co.*, 93 Md. 285; 48 Atl. 835; 53 L. R. A. 169.

⁵ *McLouth v. Hunt*, 154 N. Y. 179. For earlier cases in addition to *Re Kernochan*, 104 N. Y. 618; 11 N. E. 149; see *Woodruff's Estate*, 1 Tuck. (N. Y.) 58 (extraordinary stock dividend awarded to tenant for life without apportionment to represent profits earned before the creation of the trust); *Clarkson v. Clarkson*, 18 Barb. (N. Y.) 646 (extraordinary stock dividend awarded to tenant for life); *Simpson v. Moore*, 30 Barb. (N. Y.) 637; *Goldsmith v. Swift*, 25 Hun (N. Y.) 201; *Riggs v. Cragg*, 26 Hun (N. Y.) 89 (compare S. C. on appeal 89 N. Y. 487). Compare a very recent case, *Richmond v. Richmond*, 108 N. Y. Supp. 298, where a cash dividend of 552 per cent was awarded to the tenant for life.

reversed by the House of Lords on appeal in a ruling case which for the first time put the English law on an intelligible basis.

Some courts while expressly repudiating the doctrine that dividends are apportionable have yet declared that dividends which represent earnings are to be treated as income although payable in new shares of the company's capital, while dividends declared out of the company's old capital merely are to be treated as capital.¹ If this rule were logically followed out, all lawful dividends declared by a going concern whether payable in money or in shares of the company's capital stock would go as income without apportionment;² for we have seen that it is unlawful to pay dividends either in cash or in shares unless profits equal to the amount of the cash dividend or to the amount of the new shares have been earned. Such is perhaps now the law of New York.³ If this be indeed the doctrine of the New York Court of Appeals, it is unfortunate that the learned court does not announce the same in explicit terms.

¹ *Goldsmith v. Swift*, 25 Hun (N. Y.) 201; *Riggs v. Cragg*, 26 Hun (N. Y.) 89; *Hite v. Hite*, 93 Ky. 257; 20 S. W. 778; 40 Am. St. Rep. 189; 19 L. R. A. 173.

² The theory of some courts, for example, the Supreme Court of Kentucky, *Hite v. Hite*, 93 Ky. 257, 267; 20 S. W. 778; 40 Am. St. Rep. 189; 19 L. R. A. 173; that a lawful dividend declared out of a sum realized from an increase in value of fixed capital, such as real estate, should be regarded as capital and not income as between a tenant for life and remainderman would seem to be illogical and difficult, not to say impossible, to apply in practice. It overlooks that an increase in the value of its capital investments may be one of the sources of profit to the company and therefore one of the sources of income properly so-called to its shareholders. See *supra*, § 1314. This confusion underlies many of the cases, e. g., *Mercer v. Buchanan*, 132 Fed. 501; *Kalbach v. Clark* (Iowa), 110 N. W. 599.

³ See *Lowry v. Farmers' L. & T. Co.*, 172 N. Y. 137; 64 N. E. 796, affirming 56 N. Y. App. Div. 108 (stock dividend declared out of profits earned largely prior to the testator's death held income payable without apportionment to the tenant for life); *Robertson v. De Brulatour*, 80 N. E. 938; 188 N. Y. 301 (cash dividends out of proceeds of sale of surplus real estate by railway company most of whose property was leased to another company, and stock dividends out of profits earned largely before testator's death awarded to tenant for life without apportionment).

But see *Chester v. Buffalo Car Mfg. Co.*, 70 N. Y. App. Div. 443; 75 N. Y. Supp. 428 (note the forcible dissenting opinion); *Mercer v. Buchanan*, 132 Fed. 501 (where a federal district judge seems unconsciously to have gone counter to the doctrine of the Supreme Court as laid down in *Gibbons v. Mahon*, 136 U. S. 549; 10 Sup. Ct. 1057).

As to Maryland law, see *Atlantic*

§ 1391. **Conclusion.** — The conclusion of the whole matter is as follows: there would seem to be three and only three possible rules on the subject. (1) The first is the Massachusetts doctrine, or doctrine of the Supreme Court of the United States and of the House of Lords, that all cash dividends declared during the running of an estate for life go to the tenant for life as income and that all stock dividends go into corpus. (2) The second is the Pennsylvania doctrine that all extraordinary dividends (if not all dividends whatsoever) whether payable in cash, scrip, or stock are apportionable and go as income or as corpus according as the profits out of which they are declared were earned before or pending the estate for life. (3) The third is the doctrine that all dividends whatsoever, declared during the pendency of an estate for life (excluding dividends which amount to an unlawful reduction of capital, dividends or distributions in pursuance of lawful proceedings for the reduction of capital, and dividends in winding-up or liquidation), go as income to the tenant for life, whether payable in money, in property, or in new or additional shares of the company. Unless a court will adopt and adhere to one or the other of these rules, it must be expected to flounder helplessly and aimlessly from one to the other.

Of the three possible rules, the writer prefers the first. It is simple and logical and, while sometimes working hardship, is in the main just and equitable. The second is neither logical nor simple. It is not logical because it does not purport to abrogate the rule that a shareholder has no estate or interest in the profits of his company until they are declared as a dividend, and because it recognizes, at least in the state of its origin, that ordinary dividends are not apportionable, applying the doctrine of apportionability only to "extraordinary" dividends. It is not simple because it furnishes no means of determining at what point of time the accumulated profits of a corporation are to be

Coast Line Dividend Cases, 102 Md. 73; 61 Atl. 295 (dividend payable in stock and certificates of indebtedness awarded to life tenant); *Quinn v. Safe Deposit and Trust Co.*, 93 Md. 285; 48 Atl. 835; 53 L. R. A. 169 (extraordinary cash dividend awarded without apportionment to tenant for life).

states, the doctrine of apportionment has been repudiated without adopting any clear rule. E. g. *Greene v. Smith*, 17 R. I. 28, 31; 19 Atl. 1081 (with which compare *Bushee v. Freeborn*, 11 R. I. 149; *Re Brown and Larned*, 14 R. I. 371; 51 Am. Rep. 397); *Hite v. Hite*, 93 Ky. 257, 265; 20 S. W. 778; 40 Am. St. Rep. 189; 19 L. R. A. 173.

In a number of cases in various

taken as having been earned. The third rule is simple enough and perhaps logical enough, and is chiefly objectionable because it has never been laid down in clear terms by any court of authority.

§ 1392-§ 1395. *Dividends which amount to a Return of paid-up Capital.*

§ 1392. **In general.** — Where capital moneys — that is, part of the company's authorized capital or capital-stock — are distributed by a corporation among its shareholders, the money so distributed constitutes capital and not income as between tenants for life and remaindermen of the shares. This question can ordinarily arise only in liquidation proceedings or upon proceedings for reduction of capital; for except in such cases a corporation has ordinarily no power to return capital to the shareholders.

§ 1393. **In Proceedings for Reduction of Capital.** — In case of proceedings for the reduction of capital, there would seem to be no doubt that money distributed among the shareholders in consequence of the reduction is returned capital and must be treated as such between tenant for life and remainderman, although, to be sure, a premium or bonus paid in addition to the amount of the reduction in the nominal capital is in effect a dividend of profits and as such should go to the tenant for life.¹

§ 1394. **In Liquidation or Winding-up.** — In cases of winding-up or liquidation proceedings where the amount realized is less than sufficient to repay to the several shareholders the sums paid up on their respective shares, there can be no doubt but that money returned to the shareholders is capital rather than income as between tenant for life and remainderman.²

If the receiver or liquidator realizes more than enough to return to the shareholders the paid-up capital, a difficult question arises whether the excess should be distributed as capital or as income. The real question is whether the courts will regard all the property of a corporation as capital, whether due

¹ *Warren's Estate*, 11 N. Y. Supp. special statute); *Brownell v. Anthony*, 189 Mass. 442; 75 N. E. 746 (dividend declared before but in anticipation of passage of resolution to liquidate).
1 Ch. 289.

² *Gifford v. Thompson*, 115 Mass. 478 (winding-up without judicial proceedings but in pursuance of a

to earnings or any other source, except so much as may have been converted into profits by the declaration of a dividend by the company as a going concern, or whether accumulated earnings will be regarded as profits or income unless capitalized by proceedings for an increase of the company's legal or nominal capital. It seems that the former alternative is that accepted by the courts; and that all payments made to shareholders in proceedings for the winding-up or liquidation of the corporation, even such payments as are in excess of the paid-up capital, will be treated as capital rather than income as between a tenant for life of the shares and a remainderman.¹

A similar question sometimes arises in liquidation between the common or ordinary shareholders and preferred shareholders whose preference does not extend to capital. As elsewhere more

¹ *Armitage v. Garnett* (1893), 3 Ch. 337.

See *Wheeler v. Perry*, 18 N. H. 307; 29 Am. Dec. 664 (where it seems to have been held that all payments made to the shareholders in liquidation, which was carried on without any formal winding-up proceedings, are principal and not income as between tenants for life of the shares and remaindermen); *Walker v. Walker*, 68 N. H. 407; 39 Atl. 432 (so far as the very brief report discloses, a similar case to the preceding); *Lord v. Brooks*, 52 N. H. 72 (where dividends in liquidation in excess of the value of the stock were assimilated to dividends declared by a going concern and held to be distributable as principal or income according as the profits out of which they were paid were earned before or during the estate for life); *Clarkson v. Clarkson*, 18 Barb. (N. Y.) 646, 657-658 (as to the disposition of a bonus in bonds paid under an arrangement for consolidation); *Simpson v. Moore*, 30 Barb. (N. Y.) 637 (dividends declared in anticipation of approaching expiration of corporate existence); *Cobb v. Fant*, 36 S. Car. 1; 14 S. E. 959 (accumulations due to profits

earned prior to creation of the trust held corpus, those due to profits earned during pendency of life estate held income); *Re Rogers*, 161 N. Y. 108; 55 N. E. 393 (accumulations held profits); *Blinn v. Gillett*, 208 Ill. 473; 70 N. E. 704; 100 Am. St. Rep. 234 (where the excess was treated as capital); *Re Stevens*, 80 N. E. 358; 187 N. Y. 471 (amount received for goodwill in excess of nominal capital treated as principal); *Curtis v. Osborn* (Conn.), 65 Atl. 968 (surplus treated as principal); *Bulkeley v. Worthington Ecc. Soc.*, 78 Conn. 526; 63 Atl. 351 (surplus treated as principal); *Second Universalist Church v. Colegrove*, 74 Conn. 79; 49 Atl. 902 (where the court reaching a different conclusion from that afterwards reached on the same facts by the Supreme Court of Massachusetts in *Hemenway v. Hemenway*, 181 Mass. 406; 63 N. E. 919, held that a very peculiar transaction was tantamount to a formal liquidation).

But see *Re James*, 146 N. Y. 78, 96; 40 N. E. 876; 48 Am. St. Rep. 774. Cf. also *Mercer v. Buchanan*, 132 Fed. 501 (a confused case).

fully explained,¹ the tendency in such a case is to regard all the property of the corporation in liquidation as capital rather than profits.

Of course, the rule that cash dividends declared during a tenant for life's time are income has no application to dividends in liquidation.²

§ 1395. **Dividends unlawfully declared out of Capital by a Going Concern.** — As we have seen above, the payment of dividends out of capital instead of profits by a going concern is ordinarily unlawful, but it is sometimes accomplished notwithstanding the law. In any such case, it would seem that the amount of the so-called dividend should be treated as capital and not income as between tenants for life and remaindermen.³ The wrongful act of the corporation in declaring the dividend should not be permitted to prejudice the remainderman. Certainly, however, the presumption is that dividends paid by a corporation do not encroach upon its capital, and the litigant who asserts the contrary must affirmatively prove his case.⁴

§ 1396. **Rights of Parties upon Sale of Shares by Trustee, the Price being augmented because of anticipated Dividends or accumulated Profits.** — Where shares are sold by a trustee the entire purchase price represents corpus of the estate even though part of the money is paid on account of a sinking fund which has been

¹ *Supra*, § 567.

² *Bulkeley v. Worthington Ecc. Soc.*, 78 Conn. 526; 63 Atl. 351; *Smith v. Dana*, 77 Conn. 543, 556-557; *Brownell v. Anthony*, 189 Mass. 442, 445; 75 N. E. 746.

³ Cf. *Read v. Head*, 6 Allen (Mass.) 174; *Balch v. Hallet*, 10 Gray (Mass.) 402 (where the application of the rule as stated in the text was thought to be excluded by the peculiar terms of the will creating the trust); *Wheeler v. Perry*, 18 N. H. 307; 29 Am. Dec. 634 (where the company was deliberately winding itself up without any formal proceedings); *Walker v. Walker*, 68 N. H. 407; 39 Atl. 432

(apparently similar to last case); *Re Skillman*, 24 Abb. N. C. (N. Y.) 41; 9 N. Y. Supp. 469; *Heard v. Eldridge*, 109 Mass. 258; 12 Am. Rep. 687 (no point being made as to whether the distribution was lawful or unlawful).

But see *Footte, Appellant*, 22 Pick. (Mass.) 299, 304 (semble); *Re James*, 146 N. Y. 78, 96; 40 N. E. 876; 48 Am. St. Rep. 774 (where the corporation was formed for the express purpose of paying dividends out of its capital); *Whitwham v. Piercy* (1907), 1 Ch. 289 (stated *supra*, § 650, and § 1382).

⁴ See *supra*, § 1358.

accumulated by the company,¹ or even though the sale is made shortly before the usual dividend day;² and of course the same rule applies where, although the shares are sold for an amount greatly exceeding both their nominal value and the amount for which they were purchased on behalf of the trust estate, yet there is no evidence as to the cause of this increased value.³ Even a statute making dividends apportionable does not alter this rule or entitle the tenant for life to any part of the purchase-money although the shares are sold "cum dividend" shortly before the declaration of a dividend.⁴

§ 1397. **Rights to Dividends as between Specific and Residuary Legatees.** — As between a specific legatee of shares and the residuary legatee, the rule is comparatively simple; for there is no question as to capital and income. All dividends or bonuses of every kind declared after the testator's death, whenever the profits out of which they are paid may have been earned, go to the specific legatee,⁵ but any dividends or bonuses declared prior to the testator's death go into the residue, even though not payable until afterwards.⁶ The will is merely a conveyance of the

¹ *Re Kernochan*, 104 N. Y. 618, 625-626; 11 N. E. 149.

² *Abercrombie v. Riddle*, 3 Md. Ch. 320; *Scholefield v. Redfern*, 32 L. J. Ch. 627, 632-633 (a brief but excellent discussion of the question); *Freman v. Whitbread*, 1 Eq. 266 (loss of income by tenant for life on account of delay in completing the reinvestment insufficient to establish an equity to be recouped out of the purchase money); *Bostock v. Blakeney*, 2 Bro. Ch. 653.

But see *Londeshorough v. Somerville*, 19 Beav. 295 (distinguished in *Freman v. Whitbread*, ubi supra, as proceeding "entirely on the special circumstances," but *quære*, what special circumstances existed beyond the circumstance that the sale was made some time before the reinvestment?); *Bulkeley v. Stephens*, 10 L. T. 225.

³ *Smith v. Hooper*, 95 Md. 16; 51 Atl. 844; 54 Atl. 95.

⁴ *Bulkeley v. Stephens* (1896), 2 Ch. 241 (semble — the tenant for life being allowed a part of the purchase money, under somewhat peculiar facts, on the ground that if the trust had been carried out according to its terms without a sale, he would have been entitled to a portion of the dividend).

⁵ *Maclaren v. Stainton*, 3 De G. F. & J. 202; *Phelps v. Farmers', etc. Bank*, 26 Conn. 269 (semble); *King v. Follet*, 3 Vt. 385 (headnote misleading).

Cf. *Blinn v. Gillett*, 208 Ill. 473, 490-491; 70 N. E. 704; 100 Am. St. Rep. 234.

⁶ *Wright v. Tuckett*, 1 J. & H. 266; *Brundage v. Brundage*, 60 N. Y. 544 (scrip dividend declared and issued in testator's lifetime, but

shares speaking from the testator's death, and is subject to the same presumptions in regard to this matter as a conveyance *inter vivos*.¹

§ 1398. **Statutes making Dividends apportionable.**—In England the rule that dividends, although by the custom of the company they may be payable periodically, do not in legal contemplation accrue *de die in diem*, and hence are not apportionable, has been abrogated by statute, the Apportionment Act of 1870,² so that some of the rules of law above stated are now obsolete in that country.³ In New York, on the other hand, a statute allowing apportionment of payments made payable or becoming due at fixed periods has been held to have no application to dividends on shares.⁴

not payable or convertible into stock until after his death).

But see *Clive v. Clive*, Kay 600 (depending upon peculiar provisions of the company's deed of settlement).

¹ As to which, see *supra*, § 1375.

² 33 & 34 Vict., c. 35.

³ Cf. *Stone v. Meredith*, 78 L. T. 492 (where the application of the Apportionment Act was held to be excluded by the language of the

will); *Carr v. Griffith*, 12 Ch. D. 655; *Oppenheimer v. Boatman* (1907), 1 Ch. 399; *Bulkeley v. Stephens* (1896), 2 Ch. 241; *Pollock v. Pollock*, 18 Eq. 329; 1 Lindley on Companies, 6th ed. pp. 743-744.

⁴ *Re Kane*, 64 N. Y. App. Div. 566; 72 N. Y. Supp. 333. Cf. *Granger v. Bassett*, 98 Mass. 462, 469.

CHAPTER XXIV

DIRECTORS — THEIR APPOINTMENT, QUALIFICATIONS, RESIGNATION AND REMOVAL, THEIR POWERS AND THE MANNER OF EXERCISE THEREOF.

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§ 1399. **Nature of the Position of Directors — As Agents, Managing Partners, Trustees.** — The management of corporations is usually intrusted to a board of managers, who in the case of ordinary joint-stock corporations are called directors. To be sure, according to a recent English case, it is not absolutely necessary that a limited company formed under the Companies Act of 1862, should be managed by directors;¹ but nevertheless the all but uniform custom is to have a board of directors, and in America where the statutes do not usually allow so great flexibility in company management, the incorporation laws either by express provision or by implication generally require that joint-stock corporations be managed by directors.

The position of directors has been variously designated and described. Thus, they have been called agents;² and they certainly are for some purposes agents of the corporation.³ They have also been called "managing partners";⁴ but as they are obviously not partners at all, the phrase is helpful only by analogy. Again, they have often been called "trustees."⁵ But as a trustee is one who holds the title to property for the benefit of another, and as directors are not invested with the title to the corporate property, the inaccuracy of the appellation is apparent.⁶ The truth is that the status of director and corpora-

¹ *Bulawayo Market Offices Co. v. Ind, Coope & Co.* (1908), 1 Ch. 84. (1907), 2 Ch. 458. Cf. *infra*, § 1491.

² *Charitable Corporation v. Sutton*, 2 Atk. 400. ⁴ *London Financial Ass. v. Kelk*, 26 Ch. D. 107, 143-144; *Automatic Self-Cleaning Filter Syndicate Co. v. Cunninghame* (1906), 2 Ch. 34, 45.

³ Cf. *Bosworth v. Allen*, 168 N. Y. 157, 165; 61 N. E. 163; 85 Am. St. Rep. 667; 55 L. R. A. 751; *Holmes v. Willard*, 125 N. Y. 75, 79-80; 25 N. E. 1083; 11 L. R. A. 170. ⁵ E. g., *Cobbett v. Woodward*, 5 Sawy. 403; *Flitcroft's Case*, 21 Ch. D. 519. In some states, "trustees" is the official, statutory designation.

Although directors are agents yet they are not servants or employees, and a director cannot be deemed a "person in the employment of the company." *Normandy Robinson*, 55 Md. 419, 436. ⁶ *Bosworth v. Allen*, 168 N. Y. 157, 164; 61 N. E. 163; 85 Am. St. Rep. 667; 55 L. R. A. 751; *Booth v. Robinson*, 55 Md. 419, 436.

tion is a distinct legal relationship. It resembles in some respects those of agent and principal, of managing and dormant partners, of trustee and *cestui que trust*; but it is different from each.¹

With respect to the powers of directors and the method of their exercise, perhaps the most helpful analogy is with managing partners. So too, in considering the manner of appointment or election of directors, the most important point to bear in mind is the function which they are to perform as, so to speak, vice-principals of the company, — “managing partners” acting so far as the outside world is concerned as though they formed the corporation itself.

§ 1400—§ 1404. *Appointment or Election of Directors*’.

§ 1400. **In general.** — Since directors have such important functions to perform and have during the interval between shareholders’ meetings an almost unlimited control over the business of the company, nothing can exceed in importance to the members of the corporation the matter of their selection. In choosing directors, the corporation is giving a general power of attorney, irrevocable during their term of office except — and that only in some cases — by a difficult, tedious process. Generally, and in the absence of some express provision to the contrary in the company’s regulations, the directors are elected by the shareholders.² Usually, the majority of the shareholders may

¹ “When persons who are directors of a company are from time to time spoken of by judges as agents, trustees, or managing partners of the company, it is essential to recollect that such expressions are used not as exhaustive of the powers or responsibilities of those persons, but only as indicating useful points of view from which they may for the moment and for the particular purpose be considered — points of view at which they seem for the moment to be either cutting the circle or falling within the category of the suggested kind. It is not meant that they belong to the category, but, that it is useful for the moment to observe that they fall *pro tanto*

within the principles which govern that particular class.” Per Bowen, L. J., in *Imperial Hydropathic Hotel Co. v. Hampson*, 23 Ch. D. 1, 12.

² *State ex rel. Brun v. Oftedal*, 72 Minn. 498, 511–512; 75 N. W. 692. As to the conduct of the election, the number of votes necessary to elect, the effect of votes for disqualified candidates, etc., see *supra*, Chapter XXI. As to first directors, see *supra*, § 115 and § 168. The subscribers of the incorporation paper have no power to elect directors before incorporation. *Möller v. Maclean*, 1 Megone 274. As to directors named in a special act of incorporation, see *infra*, § 1417.

select the entire board, but sometimes the regulations provide for minority representations by means of what is called cumulative voting.¹ An election is not void because less than a full board is chosen, but those who receive a plurality although less than a full board are entitled to the office;² but it is the duty of the meeting immediately to proceed with another election to fill up the board.³ A shareholder is not bound to vote for somebody for all the vacancies to be filled, but a "ticket" containing the names of fewer persons than there are vacancies may be voted for.⁴ The validity of an election of a director cannot be affected by what he may intend doing when installed.⁵

§ 1401. **Statutes and By-laws relating to Election of Directors.**

—Of course, any provisions governing the election, whether contained in statutes applicable to the company or in the by-laws or regulations of the company, must be observed. Thus, where the company's regulations provide that the election of directors shall be deemed extraordinary business and that notice of shareholders' meetings at which extraordinary business is to be transacted shall be given in a particular manner, directors chosen at a meeting convened without such notice are not legally entitled to the office.⁶ On the other hand, provisions as to the time of election or appointment — such as a provision that directors shall be chosen at the annual meeting — are usually directory merely.⁷

§ 1402. **Contracts permitting Third Persons to name Directors.**

—The election of directors being business which the interest of the shareholders so imperatively demands shall be kept within their own control, any contract or agreement by which any other person or company is given the power to name all or any of the directors is illegal, *ultra vires*, and void.⁸ Any such arrangement

¹ See *supra*, § 1219.

² *Union Insurance Co.*, 22 Wend. (N. Y.) 591; *Wright v. Commonwealth*, 109 Pa. St. 560; 1 Atl. 794; *Forsyth v. Brown*, 33 Wkly. Notes Cas. (Pa.) 72; *Excelsior Ins. Co.*, 38 Barb. (N. Y.) 297; *Gülchrist v. Colony*, 82 S. W. 1018; 26 Ky. Law Rep. 1003.

³ *Forsyth v. Brown*, 33 Wkly. Notes Cas. (Pa.) 72.

⁴ *Vandeburgh v. Broadway Ry. Co.*, 29 Hun (N. Y.) 348.

⁵ *Railway Co. v. State*, 49 Oh. St. 668; 32 N. E. 933. Cf. *Mottu v. Primrose*, 23 Md. 482.

⁶ *Garden Gully Mining Co. v. McLister*, 1 App. Cas. 39.

⁷ *Hughes v. Parker*, 20 N. H. 58. Cf. *supra*, § 1245.

⁸ *James v. Eve*, L. R. 6 H. L. 335; *Stace and Worth's Case*, 4 Ch. 682; *Benzinger v. Kantzler*, 112 Ill. App. 293. Cf. *Lorillard v. Clyde*, 86 N. Y. 384; *Glass v. Basin, etc. Mining Co.*, 77 Pac. 302; 31 Mont. 21.

with another corporation would in effect amount to a merger or amalgamation of the two companies.¹ On the other hand, if an agreement whereby one company is to name the directors to be elected by the shareholders of another company is fully executed, the directors so chosen have all the usual powers of directors at least so far as outsiders are concerned.²

§ 1403. **Filling interim Vacancies.** — Vacancies in the board can ordinarily, it is safe to say, be filled only by the same authority that made the original appointment — that is, by the shareholders — unless the regulations of the company otherwise provide.³ Frequently, it is expressly provided that any *interim* vacancy may be filled by the continuing members of the board. In that case, the power of filling the vacancy is not terminated by the supervention of a shareholders' meeting which omits to exercise its right of filling the place.⁴ Where the continuing directors have filled the vacancy, they have no power to rescind their action.⁵ Where the directors are given power to fill "casual vacancies," they may fill a vacancy created by resignation,⁶ or by declinature of election,⁷ or, generally, in any other way than by mere lapse of time; but they cannot fill directorships newly created by an amendment to the by-laws increasing the number of directors.⁸ The power of continuing members of the board to fill vacancies cannot be exercised if their number has fallen below the minimum prescribed by the regulations⁹ or below a

¹ *Stace and Worth's Case*, 4 Ch. 682.

² *Massachusetts Const. Co. v. Kidd*, 142 Fed. 285. Cf. *Kidd v. New Hampshire Traction Co.* (N. H.), 66 Atl. 127.

³ *Sylvania, etc. R. Co. v. Hoge* (Ga.), 59 S. E. 806.

⁴ *Munster v. Cammell Co.*, 21 Ch. D. 183.

But see *Kiely v. Kiely*, 3 Ont. App. 438, 443 (semble).

⁵ *Munster v. Cammell Co.*, 21 Ch. D. 183.

⁶ *York Tramways Co. v. Wil-lows*, 8 Q. B. D. 685; *Munster v. Cammell*, 21 Ch. D. 183, 187.

⁷ *La Compagnie de Mayville v. Whitley* (1896), 1 Ch. 788, 809 (head-note inadequate).

⁸ *Re Griffing Iron Co.*, 63 N. J. Law 168; 41 Atl. 931 (affirmed 63 N. J. Law 357; 46 Atl. 1097); *Gold Bluff, etc. Corporation v. Whitlock*, 75 Conn. 669; 55 Atl. 175 (where the directors were authorized to "fill any vacancy in the board for the unexpired portion of the term").

⁹ *Newhaven Local Board v. Newhaven School Board*, 30 Ch. D. 350; *Isle of Wight Ry. Co. v. Tahourdin*, 25 Ch. D. 320, 333, 335-336; *Moses v. Tompkins*, 84 Ala. 613, 618; 4 So. 763.

Cf. *Blackwell v. State*, 36 Ark. 178, 187 (headnote inadequate).

But see contra: *Wright v. First Nat. Bank*, 52 N. J. Eq. 392, 396; 28 Atl. 719 (semble).

quorum,¹ unless there is also a provision that the continuing members may act in spite of any vacancy.² It seems that in any case where the number of directors has become so reduced that they are incompetent to act even for the purpose of filling the vacancies, a special meeting of the shareholders has inherent power to fill the vacancies.³

Persons who by statute are made eligible as directors are also qualified for appointment to fill casual vacancies.⁴

§ 1404. **Succession to Directorship by Operation of Law.** — In an Ontario case, the minimum number of directors was fixed by statute at three. There were three shareholders all of whom were directors. Upon the death of one of the three, the court held that the person to whom he bequeathed his shares became a director at once by operation of law without an election.⁵ The reasoning was that the legatee was the only person qualified for the vacancy and therefore, if an election were necessary, must have been chosen, so that the election could be regarded as a mere formality. This reasoning, however, is not satisfactory; for the other shareholders might assign some of their shares to a stranger and thus qualify him as director. The Ontario case stands absolutely alone and ought not, it is submitted, to be followed.

§ 1405-§ 1406. *Acceptance of Directorship.*

§ 1405. **Necessity for Acceptance — What is sufficient Acceptance.** — In order to constitute a person a director, some acceptance of the office is necessary.⁶ Any overt manifestation of an intent that the relation of director and company shall subsist would probably be a sufficient acceptance, but some actual entrance upon the duties of the office is not only sufficient evidence but the most satisfactory evidence.⁷ It has been said

¹ *Sovereign, etc. Co. v. Whitside*, N. Y. App. Div. 1; 47 N. Y. Supp. 12 Ont. L. R. 638. 906; *Whittaker v. Amwell Nat. Bank*,

² *York Tramways Co. v. Willows*, 52 N. J. Eq. 400; 29 Atl. 203; *Bank of Mutual Redemption v. Hill*, 56 8 Q. B. D. 685.

³ *Sovereign, etc. Co. v. Whitside*, 12 Ont. L. R. 638, 643 (semble). Me. 385 (headnote inadequate); 96 Am. Dec. 470; *Bramblet v. Commonwealth Land, etc. Co.*, 83 S. W.

⁴ *Lord v. Equitable Life Ass. Soc.*, 108 N. Y. Supp. 67. 599; 26 Ky. Law Rep. 1176; 84 S. W. 545; 27 Ky. Law Rep. 156.

⁵ *Kiely v. Kiely*, 3 Ont. App. 438. S. W. 545; 27 Ky. Law Rep. 156.

⁶ *United Growers Co. v. Eisner*, 22 ⁷ *Danville, etc. R. R. Co. v. Brown*,

that acceptance will be presumed in the absence of evidence to the contrary.¹ In some cases, even apparently conclusive evidence of acceptance may be explained away. Thus, where one G. was asked to become a director, where his name was printed as such in the prospectus, and where he had attended several meetings of the board, the court nevertheless concluded that he had never decided to accept, but was merely considering the question, and attending meetings for the purpose of gaining light on the company's interior workings.² The acceptance of the office must take place during the term for which the director was elected even though it is provided that directors shall hold over after the expiration of their term of office until the election of their successors, and even though the office is accepted before any other election is held.³ A provision in the incorporation paper requiring newly elected directors to accept office and organize as a board within a certain time after their election will be construed, as directory merely,⁴ so that the directors may nevertheless accept office and organize at any time during the term for which they were elected.

§ 1406. **Duty to accept.** — In the case of an incorporated guild of artisans, it was held that a by-law fining members who refused to accept office as wardens of the company was valid;⁵ but it may perhaps be doubted whether the same principle would apply to a similar by-law of a modern business joint-stock corporation. It can hardly be said that a shareholder in the ordinary corporation of to-day is under any duty to accept an election as director.

90 Va. 340, 342 (headnote inadequate); 18 S. E. 278.

¹ *Lockwood v. Mechanics Nat. Bank*, 9 R. I. 308, 341; 11 Am. Rep. 253; *Danville, etc. R. R. Co. v. Brown*, 90 Va. 340; 18 S. E. 278 (semble); *Halpin v. Mutual Brewing Co.*, 20 N. Y. App. Div. 583; 47 N. Y. Supp. 412.

Cf. *Delano v. Smith Charities*, 138 Mass. 63.

² *Green's Case*, 18 Eq. 428.

See also *Blake v. Bayley*, 16 Gray (Mass.) 531.

³ *Bramblet v. Commonwealth Land, etc. Co.*, 83 S. W. 599; 26 Ky. Law Rep. 1176; 84 S. W. 545; 27 Ky. Law Rep. 156.

⁴ *Jones v. Bonanza Mining, etc. Co. (Utah)*, 91 Pac. 273.

⁵ *London Tobacco Pipe Makers' Co. v. Woodruffe*, 7 B. & C. 838.

§ 1407-§ 1429. *QUALIFICATIONS OF DIRECTORS.*

§ 1407. **In general — In the Absence of express Regulations.** — In the absence of some express provision by statute or by the company's regulations no particular qualifications are required of directors. Thus, as a matter of prudence directors ought generally to be men of experience, yet even an infant probably would be legally qualified. - Certainly, a married woman may be a director.¹ So, an alien is eligible as director.² Indeed, it has recently been held in England that, if the articles of association permit, another corporation may be a director.³

§ 1408. **Validity of By-laws fixing Qualifications.** — On the other hand, the power of a corporation to enact by-laws fixing any reasonable qualifications for directors is indisputable. For instance, a by-law enacting that no person shall be a director who is engaged as counsel or attorney in any suit or proceeding against the company is valid.⁴ Moreover, it seems that a by-law may even add to qualifications of officers mentioned in a charter of incorporation.⁵

§ 1409. **Loss of Qualification — Effect in vacating Office.** — A person who is qualified as director when elected does not, in the absence of express provision, vacate his office on losing his qualification. Thus, where a person must be a beneficial owner of shares in order to be eligible as director, he does not vacate his office on ceasing to be such an owner.⁶ But where the provision is that directors shall have five shares "at their election and throughout their term of office," a transfer by a director of his

¹ *Arkansas Stables v. Samstag* (Ark.), 94 S. W. 699 (holding that *feme covert* is subject to the statutory liabilities imposed upon directors). 37 W. Va. 342; 16 S. E. 587; 18 L. R. A. 582.

² *Commonwealth v. Detwiller*, 131 Pa. St. 614; 18 Atl. 990; 7 L. R. A. 357; *Conant v. Millaudon*, 5 La. Ann. 542; *North & South Rolling Stock Co. v. People*, 147 Ill. 234; 35 N. E. 608; 24 L. R. A. 462.

³ *But see Beardsley v. Johnson*, 121 N. Y. 224, 228; 24 N. E. 380 (semble); *Ross v. Crockett*, 14 La. Ann. 811; *Oudin, etc. Mfg. Co. v. Conlan*, 75 Pac. 798; 34 Wash. 216.

⁴ *Bulawayo Market & Offices Co.* (1907), 2 Ch. 458.

⁵ *Cross v. West Va., etc. Ry. Co.*,

qualification shares vacates the office.¹ Where a director is to vacate his office on ceasing to hold his qualification shares, a director who sells his shares and within a week purchases others, all the time continuing to act, has been thought to remain a *de jure* director.²

§ 1410. **Whether Provision for Vacation of Office upon Loss of Qualification applies to Director who never was qualified.** — Conversely, a provision that a director on losing certain qualifications shall vacate his office does not, at least according to some authorities, prevent the election of one not so qualified.³ Thus, a provision that a director shall vacate his office on becoming bankrupt does not prevent the election of an undischarged bankrupt as director.⁴ But where a director was to vacate his office if he should hold any other place of profit under the company, the election as director of a person holding another office under the company was decided to be void;⁵ but this decision seems opposed to the authority above cited. A provision that a director who ceases to hold the number of shares necessary to qualify him shall vacate his office does not apply where the number of shares which he must hold is increased by amendment of the regulations during his term of office and where he has never held enough shares to qualify him under the amended regulations.⁶

§ 1411-§ 1425. REQUIRING DIRECTORS TO BE SHAREHOLDERS.

§ 1411. **In general.** — Although directors are usually selected from among the shareholders, and although this is a very commendable custom since their personal interest in the company's welfare is a great protection to the other shareholders, nevertheless no rule of the common law requires a director to be

¹ *Chemical Nat. Bank v. Colwell*, 132 N. Y. 250; 30 N. E. 644. *Packets v. Bellamy Mfg. Co.*, 12 N. H. 205, 222; 37 Am. Dec. 203 (semble); *Silsby v. Strong*, 62 Pac. 633; (1898), 1 Ch. 6 (semble).

² *Dawson v. African, etc. Co.* (1898), 1 Ch. 6 (semble).

³ *Bodega Co.* (1904), 1 Ch. 276.

Compare in addition to cases cited *infra*, *Commonwealth v. Detwiller*, 131 Pa. St. 614, 622-623; 18 Atl. 990; 7 L. R. A. 357.

⁴ *Dawson v. African, etc. Co.* (1898), 1 Ch. 6 (semble).

⁵ *Astley v. New Tivoli* (1899), 1 Ch. 151.

⁶ *Molineaux v. London, etc. Ins. Co.* (1902), 2 K. B. 589.

But see *contra*, *Despatch Line of*

a shareholder;¹ and the directors themselves (unless invested with the power of enacting by-laws) have no power by resolution to alter this rule.² Express provisions upon this important point are, however, often contained in acts of incorporation³ and in companies' regulations. Such provisions differ widely among themselves, and have little in common save the general intention of requiring directors to be shareholders. The shares which a director is required to hold by any such provision are called his qualification shares. A by-law providing that every officer must be a stockholder has been held to have no application to directors;⁴ but this construction seems rather narrow.⁵

Provisions requiring directors to be shareholders when found in general corporation laws are necessarily usually indefinite, and merely require directors to be shareholders without specifying any number of shares which they must hold. But in the regulations of particular companies or in special acts of incorporation, it is possible to fix a director's qualification at a definite number of shares. In England, this is frequently, perhaps usually, done. The practice is less common in the United States; but it is to be commended, since thereby the directors are required to have more than a mere nominal interest in the company whose destinies they so largely control.

§ 1412. **At what Time Director must qualify.**—Where the ownership of qualification shares is made a condition of eligibility, the election of an unqualified person is wholly void, and he cannot become a *de jure* director.⁶ But where the provision is

¹ *St. Lawrence Steamboat Co.*, 44 N. J. Law 529 (semble); *State v. McDaniel*, 22 Oh. St. 354; *Wright v. Springfield, etc. R. R. Co.*, 117 Mass. 226; 19 Am. Rep. 412; *Bristol, etc. Trust Co. v. Jonesboro, etc. Trust Co.*, 101 Tenn. 545, 553; 48 S. W. 228; *Florida Savings Bank v. Rivers*, 36 Fla. 575.

² *De Ruigne's Case*, 5 Ch. D. 306. The decision upon this point would be contra where the directors are invested with the power of enacting by-laws.

Cf. *Hazlehurst v. Savannah, etc. R. R. Co.*, 43 Ga. 13, 53, holding that where directors have power to enact by-laws they may upon an issue of

preferred stock contract with the subscriber that a certain number of shares of such stock should be a director's qualification.

³ See N. J. Law of 1896, § 39.

⁴ *Bristol, etc. Co. v. Jonesboro, etc. Co.*, 101 Tenn. 545, 553; 48 S. W. 228.

⁵ See *infra*, § 1660.

⁶ *Rozecrans Gold Mining Co. v. Morey*, 111 Cal. 114, 116; 43 Pac. 585.

Cf. *Cross v. West Va., etc. Ry. Co.*, 37 W. Va. 342; 16 S. E. 587; 18 L. R. A. 582; *Commonwealth v. Stevenson*, 200 Pa. 509; 50 Atl. 91.

As to whether votes cast for an unqualified person will be wholly re-

simply that a director's qualification shall be so many shares, not merely is the election of an unqualified person not void;¹ but he may even properly act as director before acquiring the qualification, and for so acting is entitled to his salary.² He is entitled to a reasonable time within which to qualify,³ unless by statute or the company's regulations, some definite period is limited for that purpose. What is a reasonable time depends largely on the special circumstances of the particular case. In one case, where as much as eight months had elapsed, the court held that a reasonable time had not expired.⁴ On the other hand, in another case where only three months had passed, it was held that more than a reasonable period had already gone by.⁵

§ 1413. **Acting without Qualification.** — *Remedies of Company in general.* — Where a person improperly acts as director without the required qualification, his conduct cannot be commended; but he does no actionable wrong to the company, for no damage can be proved to have been sustained by the corporation.⁶ Of course, as *de facto* director, he would incur the same liability for his official conduct as a *de jure* director.⁷ No doubt a corporation might enjoin an unqualified person from acting as director⁸ after the time which is allowed him for qualifying; but whatever remedy the company may have in such a case may be waived, it seems, by the other directors.⁹

jected, so as to throw the election to one who received a minority of the total vote cast, see *supra*, § 1287.

¹ *Greenough v. Alabama, etc. R. R. Co.*, 64 Fed. 22.

² *International Cable Co.*, 66 L. T. 253; *Salton v. New Beeston, etc. Co.* (1899), 1 Ch. 775.

³ *International Cable Co.*, 66 L. T. 253.

Cf. *Greenough v. Alabama, etc. R. R. Co.*, 64 Fed. 22.

⁴ *Hutchinson's Case* (1895), 1 Ch. 226, 235.

See also *Hewitt's Case*, 25 Ch. D.

283 (five months); *Karuth's Case*, 20 Eq. 506, 509–510.

⁵ *Ex parte Lord Inchiquin* (1891), 3 Ch. 28. See also *Molineaux v. London, etc. Ins. Co.* (1902), 2 K. B. 589 (four weeks).

⁶ *Coventry and Dixon's Case*, 14 Ch. D. 660.

⁷ *Infra*, § 1479.

⁸ Cf. *Garmire v. Am. Mining Co.*, 93 Ill. App. 331, and *infra*, p. 1250, n. 3.

⁹ *International Cable Co.*, 66 L. T. 253.

§ 1414-§ 1418. *Whether unqualified Person acting as Director can be deemed to subscribe for the requisite Qualification Shares.*

§ 1414. *In general.* — The question has frequently been raised in England whether a person who has acted as director can be treated by the company as subscribing to the number of shares necessary to qualify him. Mere acceptance of office and acting as director do not amount to an agreement to take from the company the requisite shares.¹ Indeed, this must be so; for the director might satisfy all his obligations by purchasing the shares from some shareholder. *A fortiori*, no agreement to take the needed shares can be implied from acceptance of office, or acting as director, where the holding of the shares is a condition of eligibility;² for in that case the election is void *ab initio* and no subsequent subscription to the required amount of capital could entitle the subscriber to the office. In any event, the only contract that can be implied from entering upon the functions of the office is an agreement to qualify within the time allowed for that purpose — that is, within a reasonable time,³ unless some definite time is prescribed — either by taking the requisite shares from the company, or by procuring them in the market, or in any other way.⁴ If this implied agreement to provide one's self in some way with the proper qualification is broken by a failure to acquire the necessary shares within the stipulated

¹ *Brown's Case*, 9 Ch. 102; *National Ins., etc. Ass'n*, 4 De G. F. & J. 78; *Bellina, etc. Tramway Co.* (1888), 21 L. R. Ir. 497.

But see *Purcell's Case*, 29 W. R. 170.

The appointment of an unqualified person as director does not amount to an offer on the company's part to allot to him the requisite qualification shares, and hence his subsequent application for such shares does not complete a contract but is a mere offer requiring acceptance by the corporation. *Onslow's Case*, 3 Times L. R. 551.

² *Barber's Case*, 5 Ch. D. 963; *Jenner's Case*, 7 Ch. D. 132; *Biron's*

Case, 26 W. R. 606. Cf. *Heartt v. Sherman* (Ill.), 82 N. E. 417 (where the court declared that the election of a person as director is an admission on the part of the company that he is a shareholder, but that if he be proved by other evidence not to have been a shareholder, the election does not amount to a contract by the company to issue the necessary qualification shares to him).

³ As to what is a reasonable time, see *Molineaux v. London, etc. Ins. Co.* (1902), 2 K. B. 589. Cf. *supra*, § 1412.

⁴ *Karuth's Case*, 20 Eq. 506, 509; *Hewitt's Case*, 25 Ch. D. 283; *Hutchinson's Case* (1895), 1 Ch. 226.

time, or in the absence of express stipulation within a reasonable time, still there is no complete contract to take the shares from the company;¹ and the failure to qualify can at most be deemed a mere offer to take the shares from the corporation if the latter chooses to allot them to him.² This offer cannot be accepted after the director has resigned,³ or the company has gone into liquidation;⁴ and acceptance should always be evidenced by formal allotment and entry of the director's name on the register,⁵ as mere lapse of time will not amount to acceptance.⁶

§ 1415. **Regulations expressly providing that Director acting without Qualification shall be a Subscriber for the Qualification Shares.** — A company's regulations may, however, be so framed that in case a director shall fail to qualify within a specified time he shall become liable to take his qualification shares from the company. If a company's memorandum of association, or articles, contain an explicit provision that a person who continues to act as director after the lapse of a stated time without obtaining his qualification shares shall be deemed to have agreed to take them from the company, any one who with knowledge of the regulations does so act after the expiration of the period limited is taken to do so subject to that provision; and accordingly an implied contract arises on his part to accept and on the company's part to allot the requisite shares.⁷ So, where the provision is that unless the director obtain his qualification shares within one month after his election he shall be deemed to have agreed to take them from the company, one who accepts the office but never actually performs its duties, nevertheless at the end of the month becomes liable to the corporation as a subscriber.⁸ Even such an express provision will not enable the company to hold as

¹ *Hutchinson's Case* (1895), 1 Ch. 226; *Re Wheal Buller Consols*, 38 Ch. D. 42.

Cf. *Hewitt's Case*, 25 Ch. D. 283, where the question was left open.

² *Hutchinson's Case* (1895), 1 Ch. 226.

³ Cf. *R. Bolton & Co.* (1894), 3 Ch. 356; *Ex parte Cammell* (1894), 2 Ch. 392.

⁴ *Hutchinson's Case* (1895), 1 Ch. 226.

⁵ See *ex parte Lord Inchiquin*

(1891), 3 Ch. 28; *Molineaux v. London, etc. Ins. Co.* (1902), 2 K. B. 589 (where the director was held liable as shareholder although he was not aware, when acting as director, that his name was on the register).

⁶ *Hutchinson's Case* (1895), 1 Ch. 226.

⁷ *Isaac's Case* (1892), 2 Ch. 158; *Salton v. New Beeston Cycle Co.* (1899), 1 Ch. 775.

⁸ *Hercynia Copper Co.* (1894), 2

a subscriber a person who accepts office and acts as director, but resigns within the period allowed him for qualifying.¹

§ 1416. **Liability of acting Director by Estoppel.** — Under some circumstances the director may be held as a subscriber for his qualification shares by estoppel. For instance, if with his knowledge and without objection his name is entered on the register of shareholders in respect of such shares, so that the public may be misled, he might be held to be estopped to deny the truth of this representation, and therefore to be a subscriber by estoppel. Even if the entry in the register were made without his knowledge, still it has been held that he cannot on that account excuse himself, and that he is liable by estoppel in respect of the shares.² One may perhaps doubt whether the American courts would hold that the mere presence of a director's name on the register for the number of shares necessary to qualify him is sufficient to raise an estoppel against him unless he could be shown to have been privy to the entry or to have acquiesced therein after knowledge thereof. However, under the National Banking Act, which requires each director throughout his term of office to hold at least ten shares and obliges him upon accepting the office to swear that he holds the requisite qualification, the United States Supreme Court held that a person who was not previously a shareholder and in whose name more than the required number of shares were registered the day before his election as director and who as an officer of the company was charged with the duty of keeping the register of shareholders was estopped from denying liability in respect of the shares which stood in his name.³

§ 1417. **Liability of Person named as Director in a special Act of Incorporation.** — Where a person is named as director in a special act of incorporation which is passed at his instance and which makes the holding of a certain number of shares a qualification for that office, he comes under a special statutory obligation to take from the company the requisite shares.⁴ This obligation does not rest upon any implied contract, but on the

¹ *R. Bolton & Co.* (1894), 3 Ch. But see *Ex parte Cammell* (1894), 356. Cf. *Self-Acting Sewing Machine Co.*, 54 L. T. 676.

² *Finn v. Brown*, 142 U. S. 56;

³ *Ex parte Lord Inchiquin* (1891), 12 Sup. Ct. 136.

⁴ *Kincaid's Case*, 11 Eq. 192; *Portal v. Emmons*, 1 C. P. D. 664.

will of the legislature.¹ It seems, however, that the shareholder may be released therefrom by the assent or acquiescence of the company.²

§ 1418. **Discharge of Obligation.** — When once a director has incurred the obligation of taking his qualification shares from the company, that obligation, however it arose, whether by implied contract, by estoppel, or by statute, is not discharged by the subsequent acquisition of a sufficient number of shares by transfer from some other holder.³ The obligation of the director is that of a subscriber for shares, and cannot be discharged except in the ways in which an ordinary subscription for shares may be discharged.⁴

§ 1419. **Rights of a Transferee of a Director's Qualification Shares.** — The election as director of a person who has transferred his qualification shares by an unregistered transfer to a person who connives at the arrangement does not work a forfeiture of the latter's interest so as to make the shares, which stand in the name of the director, attachable by the director's creditors.⁵

§ 1420–§ 1423. *To whom the Requirement of Qualification applies.*

§ 1420. **First Directors.** — The question has been raised whether provisions fixing a director's qualification in respect to the holding of shares apply to first directors, who are named in the incorporation paper,⁶ or otherwise appointed by the promoters. Where the provision is that the holding of a certain number of shares shall be a condition to *eligibility*, very clearly one who is nominated as director by the memorandum or articles of association and is not *elected* at all cannot be affected;⁷ and

¹ *Forbes' Case*, 19 Eq. 353.

or acquiescence of the company, see

² *Kipling v. Todd*, 3 C. P. D. 350. *supra*, § 1417.

But cf. *Tahourdin v. Weston-Super-Mare Grand Pier Co.*, 4 Times L. R. 124.

⁵ *Kern v. Day*, 45 La. Ann. 71, 75; 12 So. 6.

⁶ See *supra*, § 115, § 168.

³ *Ex parte Lord Inchiquin* (1891), 3 Ch. 28.

⁷ *Ex parte Stock*, 33 L. J. Ch. 731 (semble). But such a provision ap-

⁴ As to discharge by agreement applies to a person chosen as additional

the same thing is true where the provision is that "no person shall be eligible to or *continue* in the office of director" without holding a certain number of shares.¹ But in other cases, more room exists for doubt. Of course, the first directors cannot be expected to qualify until after the first allotment has been made; and this circumstance has sometimes been thought and even held an obstacle to deciding that a provision requiring a qualification is applicable to first directors.² But a better view seems to be that the provision does apply to first directors, but that they have until the expiration of a reasonable time after the first allotment of shares to comply therewith.³ In some companies, first directors are expressly required so to qualify.⁴ According to a decision rendered in the District of Columbia, a provision requiring the directors to be shareholders applies to the first directors and makes it necessary that the persons named in the incorporation paper as the first directors shall by subscribing that paper become the holders of the shares requisite to qualify them.⁵ It has been held in New Jersey that a general statutory provision requiring directors to be shareholders has no application to the first directors of a consolidated corporation who are named in the articles of amalgamation.⁶

§ 1421. **Directors of a Branch Office.**—Provisions fixing the qualification of directors apply only to members of the board which exercises general supervision over all the company's affairs, and not to so-called "provincial directors" charged with the management of branch offices.⁷

director by the original board. *Car-michael and Hewett's Case*, 30 W. R. 742. A provision that "every director shall at the time of his appointment and thenceforth throughout his continuance in office" hold at least four shares has been held to apply to first directors appointed by the articles of association. *Esparto Trading Co.*, 12 Ch. D. 191 (headnote inadequate).

¹ *Consolidated Copper Co. v. Peddie*, 5 Rettie 393, 408-413.

² *Portuguese Consolidated Mines*, 42 Ch. D. 160, 164-165; *Hamilton Trust Co. v. Clemes*, 163 N. Y. 423, 426 (headnote inadequate); 57 N. E. 614; *Davidson v. Westchester*

Gas-Light Co., 99 N. Y. 558, 565-566; 2 N. E. 892; *McDowall v. Sheehan*, 129 N. Y. 200, 207; 29 N. E. 299.

Cf. *York Tramways Co. v. Willows*, 8 Q. B. D. 685; *Norman v. Mitchell*, 5 De G. M. & G. 648, 664.

³ *Karuth's Case*, 20 Eq. 506, 509.

See also *Kincaid's Case*, 11 Eq. 192; *Forbes' Case*, 19 Eq. 353; *Portal v. Emmons*, 1 C. P. D. 664.

⁴ See *Isaac's Case* (1892), 2 Ch. 158.

⁵ *Dancy v. Clark*, 24 App. D. C. 487, 506-509.

⁶ *Camden Safe Deposit, etc. Co. v. Burlington Carpet Co.*, 33 Atl. Rep. 479 (N. J. Ch.).

⁷ *Ex parte Cotterell*, 32 L. J. Ch. 66.

§ 1422. **Directors who are in Office at Time of Adoption of Regulation requiring the Qualification.** — Where an amendment to the charter or regulations of a corporation is had by which directors are required to hold qualification shares, the provision should ordinarily be held to be prospective merely and not to apply to directors then in office. At all events an amendment providing that the “future qualification” of a director should be one hundred shares, was held to mean that such should be the qualification required of *future directors*.¹

§ 1423. **Directors after Commencement of winding-up Proceedings.** — The qualification does not cease to be required even after the company has commenced liquidation proceedings and after the transferability of its shares has been terminated.²

§ 1424–§ 1425. *What Kind of Ownership of Shares will qualify a Director.*

§ 1424. **In general — Ownership as Trustee, Executor, etc.** — A regulation requiring directors to own one or more of the corporation’s shares is satisfied, in the absence of express provision to the contrary, by an ownership as trustee without any beneficial interest,³ or even by ownership as executor;⁴ and conversely it is not satisfied by a mere unregistered equitable title to shares.⁵

¹ *Hamilton’s Case*, 8 Ch. 548.

² *Richards v. Attleborough Nat. Bank*, 148 Mass. 187; 19 N. E. 353; 1 L. R. A. 781.

³ *Haines v. Kinderhook, etc. Ry.*, 33 N. Y. App. Div. 154, 158; 53 N. Y. Supp. 368; *St. Lawrence Steamboat Co.*, 44 N. J. Law 529. 541–542; *Argus Printing Co.*, 1 N. Dak. 434; 48 N. W. 347; 26 Am. St. Rep. 639; *State v. Ferris*, 42 Conn. 560; *State v. Leete*, 16 Nevada 242.

But see contra, *Re Elias*, 40 N. Y. Supp. 910; 17 N. Y. Misc. 718.

Cf. also *Chemical Nat. Bank v. Colwell*, 132 N. Y. 250; 30 N. E. 644; *Bartholomew v. Bentley*, 1 Oh. St. 37, 43–44 (where transfer of shares without consideration in order to qualify transferee as director

was thought to be a fraud on the law).

As to the qualification of a bankrupt whose shares have not been transferred to the assignee, see *State v. Ferris*, 42 Conn. 560; *Atlas Nat. Bank v. Gardner Co.*, 8 Biss. 537.

As to whether a director who is qualified by shares held in trust is accountable to the *cestui que trust* for his salary, see *infra*, § 1497.

⁴ *Schmidt v. Mitchell*, 101 Ky. 570; 41 S. W. 929; 72 Am. St. Rep. 427.

⁵ *Argus Printing Co.*, 1 N. Dak. 434; 48 N. W. 347; 26 Am. St. Rep. 639.

Cf. *Re Leslie*, 58 N. J. Law 609; 33 Atl. 954.

But see *State v. Smith*, 15 Oreg.

But where the requirement is that a director shall own stock "in his own right," it seems clear that a different result should be reached, and that beneficial ownership would be necessary. The contrary is held in England;¹ but the conclusion was drawn from the peculiar provision in the British statutes forbidding trusts of shares to be entered on the register of shareholders, and has moreover been severely criticised,² so that there is no likelihood of its being adopted in America. Whether or not the registered holder of shares subject to an equitable mortgage or charge owns "in his own right" within the meaning of such regulations is perhaps a debatable question in the United States. Even in England, a bankrupt whose trustee has notified the company that he claims shares standing in the bankrupt's name no longer holds "in his own right,"³ and where shares are registered in the name of "F. liquidator of the H. Company," F. does not hold the shares in his own right so as to be qualified as director.⁴

There is nothing illegal in transferring shares into another's name in order to qualify the latter as director but with the understanding that he shall hold for the benefit of the transferor.⁵

Where a director's qualification is one hundred shares, a member of a partnership which owns that number of shares is

98; 14 Pac. 814; 15 Pac. 137, 386, holding that a person to whom shares have been assigned with a power of attorney to effect a transfer on the books is qualified to be director under a statute requiring directors to be shareholders.

¹ *Pulbrook v. Richmond Consolidated Mining Co.*, 9 Ch. D. 610, 614-615; *Bainbridge v. Smith*, 41 Ch. D. 462; *Cooper v. Griffen* (1892), 1 Q. B. 740; *Howard v. Sadler* (1893), 1 Q. B. 1; *Sutton v. English & Colonial Produce Co.* (1902), 2 Ch. 502 (semble).

² *Bainbridge v. Smith*, 41 Ch. D. 462 (per Cotton, L. J.); *Howard v. Sadler* (1893), 1 Q. B. 1.

Compare also the construction given in England to these same words, "in his own right," in other statutes. *Sutton v. English & Colo-*

nial Produce Co. (1902), 2 Ch. 502, 507-508.

³ *Sutton v. English & Colonial Produce Co.* (1902), 2 Ch. 502.

⁴ *Boschoek Proprietary Co. v. Fuke* (1906), 1 Ch. 148.

⁵ *Cooper v. Griffen* (1892), 1 Q. B. 740; *State v. Leete*, 16 Nevada 242; *Budd v. Munroe*, 18 Hun (N. Y.) 316, 318 (headnote inadequate).

But see *infra*, § 1615.

Cf. *Re Argus Printing Co.*, 1 N. Dak. 434, 453; 48 N. W. 347; 26 Am. St. Rep. 639; *Re Leslie*, 58 N. J. Law 609, 618-619; 33 Atl. 954; *Scott v. Scott*, 68 N. H. 7 (headnote inadequate); 38 Atl. 567; *Bartholomew v. Bentley*, 1 Oh. St. 37 (stated *supra*, p. 1176, n. 3); *Kern v. Day*, 45 La. Ann. 71, 75; 12 So. 6; *Hoopes v. Basic Co.* (N. J.), 61 Atl. 979.

qualified to be a director.¹ One who is as against the company estopped to deny his ownership of a certain number of shares is not, it has been said, by such estoppel qualified as director in respect of those shares.²

The register of shareholders is not conclusive with respect to the qualification of a director, even though it be final as to the persons entitled to vote as shareholders³ — a man may be qualified as director whose vote cannot be received at the election.

§ 1425. **Ownership of Shares in a constituent or in a holding Company.** — The opinion has been expressed *obiter* that where a corporation is formed by the consolidation of two corporations, a requirement that directors shall be shareholders would be gratified by the ownership of shares in one of the constituent companies although the old certificates had not been exchanged, as provided in the articles of amalgamation, for a certificate of ownership of shares in the consolidated company.⁴

It may be open to argument whether an officer of a corporation which owns shares in another company is qualified by virtue of such ownership to be a director of the latter corporation if directors are required to be shareholders.⁵

§ 1426. **Holding another Office as Disqualification.** — Unless expressly prohibited, a director may hold another office under the same company,⁶ or may act as director in a rival company.⁷ A provision that the office of director shall be vacated if the incumbent accept any other office under the company does not apply where no remuneration is received for performing the duties of the other office.⁸ But a similar provision was held to apply where the director was also a trustee under a deed to secure

¹ *Dunster's Case* (1894), 3 Ch. 33 Atl. Rep. 479 (headnote inadequate).
473 (headnote misleading).

² *Murray v. Bush*, L. R. 6 H. L. 37, 50–51 (per Lord Chelmsford).
⁵ See *Chase v. Tuttle*, 55 Conn. 455, 465–467; 12 Atl. 874; 3 Am.

³ *St. Lawrence Steamboat Co.*, 44 St. Rep. 64.
N. J. Law 529, 540 (semble).

⁶ *Sargent v. Webster*, 13 Metc. (Mass.) 497; 46 Am. Dec. 743.

⁷ *London, etc. Co. v. New Mashonaland, etc. Co.*, W. N. (1891) 165.

⁸ *Iron Ship Coating Co. v. Blunt*,
⁴ *Camden Safe Deposit, etc. Co. v. Burlington Carpet Co.* (N. J. Ch.), 3 C. P. 484.

the company's debentures and was remunerated by the corporation for acting as such trustee.¹ In some of the old cases, it is said that an officer of a corporation impliedly resigns by accepting an "incompatible office" in the same corporation;² but this generality has little or no practical bearing at the present day.³ A director's acceptance of an appointment as receiver for the corporation does not vacate his office of director.⁴ It has been held that a director who in violation of his company's regulations holds the position and performs the duties of the position of superintendent of the corporation is nevertheless entitled to the salary attaching to the latter office.⁵

§ 1427. **Interest in Contracts with Company as Disqualification.**— Sometimes it is provided that a director shall vacate his office if he shall be concerned in any contract with the company without declaring his interest therein. Such a regulation is not satisfied by a mere declaration that he has an interest, but the nature of the interest must be specified.⁶ The penalty of forfeiture of office is cumulative, and does not validate the contract, which on general principles of equity is voidable;⁷ nor does it prevent the company from claiming the profits of the misconducting director, which on similar principles are recoverable.⁸ The provision may, of course, be so worded that the office shall be *ipso facto* vacated on the making of a forbidden contract;⁹ but if possible the regulation will be construed as creating merely a cause of forfeiture of office and conferring a power of removal.¹⁰ In an early case it was held that the contracts referred to in provisions such as those now being considered are contracts made in the prosecution of the corporation's regular business,

¹ *Astley v. New Tivoli* (1899), 1 Ch. 151.

² *Regents of Univ. of Md. v. Williams*, 9 G. & J. (Md.) 365, 422; 31 Am. Dec. 72.

³ See, however, *Iron Ship Coating Co. v. Blunt*, 3 C. P. 484, 489, where Montague Smith, J., expressed the opinion that the office of secretary is "incompatible" with that of director.

⁴ *Venner v. Denver Union Water Co. (Colo.)*, 90 Pac. 623.

⁵ *Neall v. Hill*, 16 Cal. 145; 76 Am. Dec. 508.

⁶ *Imperial Mercantile Ass'n v. Coleman*, L. R. 6 H. L. 189.

⁷ *Aberdeen Ry. Co. v. Blaikie*, 1 Macq. H. L. 461, 476 (distinguishing *Foster v. Oxford Ry. Co.*, 13 C. B. 200).

⁸ *Imperial Mercantile Ass'n v. Coleman*, L. R. 6 H. L. 189.

⁹ *Bodega Co.* (1904), 1 Ch. 276; *Cupit v. Park City Bank*, 20 Utah 292; 58 Pac. 839.

¹⁰ *Turnbull v. West Riding, etc. Club*, 70 L. T. 92, 94 (headnote inadequate).

But see *Bodega Co.* (1904), 1 Ch. 276.

and do not prevent the directors of a railway company from acting as its bankers.¹ The limits of this doctrine would be difficult to define, and the reason for its existence is still more inscrutable; it is not likely to be followed at the present day.

§ 1428. **Absence from Meetings of Board as Disqualification.** — Another circumstance sometimes made a cause for loss of office as director is absence from meetings of the board. A provision that the office shall be vacated if the incumbent “absents himself” from directors’ meetings for a specified period applies only where the absence is voluntary and deliberate, and not where it is due to illness.² Under such a provision, the period of absence does not begin to run until the first meeting which the director ought to, but does not, attend.³ But, apart from some express provision in either the statutes or the company’s regulations, not even protracted and unwarranted absence from board meetings will amount to an abandonment of the office, or justify a declaration that the seat has become vacant.⁴

§ 1429. **Requirement that new Director shall be recommended by old Board.** — If the corporation has a by-law or regulation making any person ineligible as director unless he be recommended by the directors or unless a fortnight’s notice of his candidacy shall have been given, an attempted election of a candidate by the directors themselves is a sufficient recommendation, and the same is true of a previous agreement among the directors that certain persons should be chosen.⁵ The validity of such a by-law restricting the shareholders’ freedom of choice would probably be seriously questioned in America.

§ 1430. **Number of Directors.** — The number of directors is often fixed by the incorporation paper. Sometimes it is left for determination by the by-laws of the company. In any case, some

¹ *Sheffield, etc. Ry. Co. v. Woodcock*, 7 M. & W. 574.

² *Mack’s Claim*, W. N. (1900) 114.

But see *McConnell’s Claim* (1901), 1 Ch. 728.

³ *McConnell’s Claim* (1901), 1 Ch. 728, 731–732 (headnote inadequate).

⁴ *Halpin v. Mutual Brewing Co.*, 20 N. Y. App. Div. 583; 47 N. Y. Supp. 412; *Phelps v. Lyle*, 10 A. & E. 113.

But cf. *Bartholomew v. Bentley*, 1 Oh. St. 37; *Sturges v. Vanderbilt*, 73 N. Y. 384, 391.

⁵ *Transport, Ltd. v. Schonberg*, 21 Times L. R. 305, 307.

method of altering the number from time to time as may be deemed expedient is usually provided. Where the number is fixed by the incorporation paper, a resolution increasing or reducing the number does not take effect until it becomes operative as an amendment to the incorporation paper by being duly recorded; and hence, in such a case where a resolution is passed reducing the number, and the meeting forthwith proceeds to an election before the resolution is recorded, those persons who receive the highest number of votes up to the number of vacancies existing prior to the reduction are duly elected as directors.¹ On the other hand, where a resolution is passed increasing the number of directors and at the same meeting before the resolution is recorded persons are chosen to fill the new directorships, the persons so elected hold by color of right, and, therefore, become *de facto* directors.² Indeed, where a larger number of directors are chosen than the number fixed by the company's incorporation paper, the directors so chosen are at least *de facto* directors,³ and their right to exercise the powers of the office cannot be questioned by a shareholder who participated in the election.⁴ Of course, where the number of directors is regulated merely by the by-laws, a by-law increasing the number may become operative immediately, and therefore the new directors may properly be elected forthwith at the same meeting by which the by-laws are amended.⁵ The legality of electing less than the full legal number of directors is set forth above,⁶ and the effect of the reduction of the number of directors by casual vacancies below the full legal quota or below the legal minimum is considered below.⁷

§ 1431. **Resignation of Directors.** — Even where a director accepts election for a definite term, he is not bound to serve until its expiration, but may resign in the meantime.⁸ His resign-

¹ *Westchester Trust Co.*, 186 N. Y. 215.

² *Werle v. Northwestern Flint, etc. Co.*, 104 N. W. 743; 125 Wis. 534.

³ See *infra*, § 1477.

⁴ *Jackson v. Crown Point Mining Co.*, 21 Utah 1. See *infra*, § 1485.

⁵ *Gold Bluff, etc. Corp. v. Whitlock*, 75 Conn. 669; 55 Atl. 175.

⁶ *Supra*, § 1401.

⁷ *Infra*, § 1456. As to the effect

of reduction in number of directors below a quorum, see *infra*, § 1455.

⁸ *Briggs v. Spaulding*, 141 U. S. 132, 154; 11 Sup. Ct. 924; *Fearing v. Glenn*, 73 Fed. 116; 19 C. C. A. 388; *Squires v. Brown*, 22 How. Pr. (N. Y.) 35.

But see *South London Fish Market*, 39 Ch. D. 324; *Timolat v. Held Co.*, 17 N. Y. Misc. 556; 40 N. Y. Supp. 692; *Bosworth v. Allen*, 168

nation in order to take effect does not require the assent or acceptance of the corporation,¹ and may be either oral or in writing.² It has been held that directors have no power, even when authorized to exercise all the powers of the company, to receive or accept the resignation of one of their number, and that such resignation in order to constitute a release from the obligations of the office must be communicated to a shareholders' meeting, although the court conceded that the meeting could not decline to accept it.³ But this case, in as far as it holds that a director's resignation handed to the other members of the board, is nugatory, is in conflict with other decisions,⁴ in which, however, the question was not discussed. A director's resignation after having been communicated to the company cannot be withdrawn without the company's consent even before it has been accepted or acted upon.⁵ Where all the directors attempt to resign for

N. Y. 157; 61 N. E. 163; 85 Am. St. Rep. 667; 55 L. R. A. 751 (as to liability for resigning for the purpose of transferring control to fraudulent conspirators).

¹ *Glossop v. Glossop* (1907), 2 Ch 370; *Chandler v. Hoag*, 2 Hun (N. Y.) 613 (but see s. c., 63 N. Y. 624); *Smith v. Danzig*, 64 How. Pr. (N. Y.) 320; *Squires v. Brown*, 22 How. Pr. (N. Y.) 35, 46.

Cf. *Noble v. Euler*, 20 N. Y. App. Div. 548; 47 N. Y. Supp. 302 (resignation of secretary); *Bruce v. Platt*, 80 N. Y. 379; *International Bank v. Faber*, 86 Fed. 443; 30 C. C. A. 178 (resignation of secretary).

But see *Regents of Univ. of Md. v. Williams*, 9 G. & J. (Md.) 365, 422; 31 Am. Dec. 72; *Venner v. Denver Union Water Co.* (Colo.), 90 Pac. 623 (where the director continued to act notwithstanding his tender of resignation and where the company's regulations provided that directors should hold office until the election of their successors).

As to conditional or qualified resignation, see *Savannah Mills v. Cunningham*, 100 Ga. 468; 28 S. E. 435.

² *Fearing v. Glenn*, 73 Fed. 116; 370.

19 C. C. A. 388; *Briggs v. Spaulding*, 141 U. S. 132, 154; 11 Sup. Ct. 924.

As to what amounts to a resignation see further *Union Nat. Bank v. Scott*, 53 N. Y. App. Div. 65, 72-73; 66 N. Y. Supp. 145.

As to resignation implied from long-continued abandonment or neglect of all the duties of the office, see *Bartholomew v. Bentley*, 1 Oh. St. 37, 42-43.

³ *Municipal Freehold Land Co. v. Pollington*, 63 L. T. 238.

⁴ *York Tramways Co. v. Willows*, 8 Q. B. D. 685; *Munster v. Cammell Co.*, 21 Ch. D. 183; *Bruce v. Platt*, 80 N. Y. 379, 383; *Fearing v. Glenn*, 73 Fed. 116; 19 C. C. A. 388; *Transport, Ld. v. Schonberg*, 21 Times L. R. 305, 307.

Cf. *Briggs v. Spaulding*, 141 U. S. 132, 154 (headnote inadequate); 11 Sup. Ct. 924 (holding that a resignation communicated to the president of the company is effective); *Glossop v. Glossop* (1907), 2 Ch. 370 (holding that resignation addressed to the company cannot be retracted even before it is presented to any meeting of directors or shareholders).

⁵ *Glossop v. Glossop* (1907), 2 Ch.

the purpose of leaving the company without officers so as to justify the appointment of a receiver, the resignations are void.¹ A contract by directors of a corporation to resign is not necessarily illegal: upon an assignment of their shares, constituting a controlling interest in the company, they may lawfully agree to resign, and thus place the control of the company at once in the hands of the purchasers.²

§ 1432. **Removal of Directors.** — No power to remove a director who has been elected for a definite term inheres in the nature of a corporation; and therefore where no power of removal is given by the company's regulations an attempt by the shareholders in general meeting to remove a director during his term does not create a vacancy, and one elected in his room acquires no title to the office.³ Such a removal may, to be sure, be so far effective that the court will not force the distasteful director upon an unwilling company;⁴ but in order to justify the removal so as to create a legal vacancy in the board, the regulations of the corporation must first be altered so as to confer the power of removal, and then that power should be exercised.⁵ Of course, where a director is elected without any limit being set to his term, his tenure of office must necessarily be at the will of the corporation, and he may be removed by the share-

¹ *Zeltner v. Zeltner Brewing Co.*, 174 N. Y. 247; 66 N. E. 810; 95 Am. St. Rep. 574.

² *Barnes v. Brown*, 80 N. Y. 527. Cf. *infra*, § 1614.

³ *Imperial Hydropathic Hotel Co. v. Hampson*, 23 Ch. D. 1; *Powers v. Blue Grass Bldg., etc. Ass'n*, 86 Fed. 705; *Stephenson v. Vokes*, 27 Ont. (Can.) 691.

But see *Boston Deep Sea, etc. Co. v. Ansell*, 39 Ch. D. 339, where a removal for misconduct was held legal.

Cf. *Nathan v. Tompkins*, 82 Ala. 437, 448; 2 So. 747; *Griffing Iron Co.*, 63 N. J. Law 168, 175; 41 Atl. 931; *Adamantine Brick Co. v. Woodruff, MacA. & Mack*, (D. C.) 318; *Bayless v. Bybee*, 1 Freem. Ch. (Miss.) 161; *O'Neal v. F. A. Neider Co.*, 80 S. W. 451; 25 Ky. Law Rep. 2279; *Gold Bluff Mining, etc. Corp.*

v. Whitlock, 75 Conn. 669; 55 Atl. 175 (as to attempts to shorten the term of office of directors previously chosen); *Fawcett v. Charles*, 13 Wend. (N. Y.) 473 (where it was thought that the power of a private corporation to remove an officer was unquestionable); *Foster v. Greenwich Ferry Co.*, 5 Times L. R. 16.

As to removal by the legislature of directors appointed to represent the state, see *Tucker v. Russell*, 82 Fed. 263.

⁴ *Infra*, § 1509.

⁵ *Imperial Hydropathic Hotel Co. v. Hampson*, 23 Ch. D. 1; *Griffing Iron Co.*, 63 N. J. Law 168; 41 Atl. 931 (affirmed 63 N. J. Law 357; 46 Atl. 1097).

Cf. *O'Neal v. F. A. Neider Co.*, 80 S. W. 451; 25 Ky. Law Rep. 2279.

holders without any explicit power to that effect. If the shareholders have power to remove a director for "reasonable cause," the courts have no power (unless fraud be proved) to review their conclusion that such cause exists.¹ But in any case of removal for cause, the accused director must be notified of the charges against him and be given an opportunity to present his defence; for if he is afforded no notice or hearing the attempted removal will be void.² It may be doubted whether a contract by a corporation not to exercise in the case of a particular director a power of removal conferred upon the shareholders by the regulations of the company would be valid; and it would seem fairly clear that such a contract should not be specifically enforced by a court of equity.³ A court of law or equity has no inherent power to remove for misconduct a director who has been duly elected and who is qualified according to law and the regulations of the corporation;⁴ but sometimes statutes confer such a power upon the courts. It has been held that such a statute justifies the court in removing a director on account of misconduct committed by him as an *officer* of the corporation rather than in his capacity of director,⁵ and that the power of removal may be exercised on account of misconduct committed before a re-election of the guilty director, which does not serve to condone his offence.⁶

§ 1433. **Expiration of Term of Office — Holding over.** — Directors are usually appointed for a definite term of office. If no limit is set to their tenure of office, they must necessarily hold, as stated above, at the will of the shareholders. Where, as is usually the case, they are chosen for a fixed term, it is very commonly provided that they shall continue to hold, even after the expira-

¹ *Inderwick v. Snell*, 2 Mac. & G. 216. Cf. *State v. Kupferle*, 44 Mo. 154; 100 Am. Dec. 265.

² *Turnbull v. West Riding, etc. Club*, 70 L. T. 92, 94 (headnote inadequate); *Commonwealth v. Detwiler*, 131 Pa. St. 614, 635-636 (headnote misleading); 18 Atl. 990; 7 L. R. A. 357; *People ex rel. Copland v. Minong Mining Co.*, 33 Mich. 2. Cf. *supra*, p. 580, n. 1.

³ *Browne v. La Trinidad*, 37 Ch. D. 1 (headnote inadequate). See also *infra*, § 1509.

⁴ *Robertson v. Bullions*, 11 N. Y. 243; *Bayless v. Bybee*, 1 Freem. Ch. (Miss.) 161. Cf. *Neall v. Hill*, 16 Cal. 145; 76 Am. Dec. 508.

But see *Ward v. Davidson*, 89 Mo. 445; 1 S. W. 846 (holding that directors may be removed for misconduct but not otherwise).

⁵ *People v. Lyon*, 104 N. Y. Supp. 319.

⁶ *People v. Lyon*, 104 N. Y. Supp. 319.

tion of the term, until the election of their successors.¹ Such a provision, guarding as it does against the possibility of the company being left without directors if for any reason the election should not be held at the appointed time, is highly salutary. Indeed the convenience of such a rule is so great that, even without any express provision on the subject, the inclination of the courts should be to permit directors to hold over until successors are ready to take their places.² But even if directors may hold over until the election of their successors, it seems that they are not bound to do so; and consequently a director whose term of office has expired and who, having sold all his shares has ceased to have any connection with the corporation is not responsible for what may subsequently befall the company.³ At all events, if they do so hold over, they are at least *de facto* directors;⁴ they hold under color of right. Where it is provided that directors shall hold over until the election of their successors, a failure to hold the election on the appointed day does not put the old directors in office for another full term, but they are liable to be displaced by persons who may be chosen at any general meeting of the company.⁵ Moreover, a provision that an officer shall hold over until his successor is chosen does not prevent him from resigning in the meantime, nor prevent the termination

¹ See *Huguenot Nat. Bank v. Studwell*, 6 Daly (N. Y.) 13.

As to the presumption that the old directors hold over where there is no proof of an election of successors, see *Appleton v. American Malt-ing Co.*, 54 Atl. 454; 65 N. J. Eq. 375; *Seebeck v. King*, 34 N. Y. Misc. 483; 70 N. Y. Supp. 322.

² *Wier v. Bush*, 4 Litt. (Ky.) 429, 433; *McCall v. Byram Mfg. Co.*, 6 Conn. 428; *Cassell v. Lexington, etc. Co.*, 9 S. W. Rep. 701; 10 Ky. Law Rep. 486; *Nashville Bank v. Petway*, 3 Humph. (Tenn.) 522; *Cahill v. Kalamazoo Mut. Ins. Co.*, 2 Doug. (Mich.) 124; 43 Am. Dec. 457; *Yourcee v. Home Town Mut. Ins. Co.*, 180 Mo. 153; 79 S. W. 175; *Hatch v. Lucky Bill Mining Co.*, 25 Utah 405; 71 Pac. 865; *Sturges v. Vanderbilt*, 73 N. Y. 384, 391 (semble).

Cf. *People v. Runkle*, 9 Johns.

(N. Y.) 147; *Sparks v. Farmers' Bank*, 3 Del. Ch. 274; *Kent County Agricultural Society v. Housman*, 81 Mich. 609; 46 N. W. 15.

But see *People v. Twaddell*, 18 Hun (N. Y.) 427; *Van Amburgh v. Baker*, 81 N. Y. 46; *First Nat. Bank v. Lamon*, 130 N. Y. 366, 368-369; 29 N. E. 321; *Potts v. Rose Valley Mills*, 167 Pa. St. 310; 31 Atl. 655.

³ *Sturges v. Vanderbilt*, 73 N. Y. 384, 391.

⁴ *Thorington v. Gould*, 59 Ala. 461; *Millikin v. Steiner*, 56 Ga. 251; *Nashville Bank v. Petway*, 3 Humph. (Tenn.) 522.

⁵ *Burr v. M'Donald*, 3 Gratt. (Va.) 215, 235; *Sylvania, etc. R. Co. v. Hoge* (Ga.), 59 S. E. 806.

of his holding by agreement with the company before a permanent successor is chosen.¹ Under a provision that directors shall hold office for one year from the time of their election and until their successors are chosen, directors who are chosen to fill interim vacancies hold over after the year of office for which their predecessors were chosen until the election of successors.²

§ 1434. **Effect of Loss of all Directors.** — In view of the important functions of directors, it is highly desirable that their number should never be allowed to fall to zero or below a competent quorum. But although the contrary was held or thought in early days, yet it is now well settled that even the loss of all the directors does not work a dissolution of the company.³ There is still power in the shareholders to elect new directors, and thus revive the regular corporate organization.

§ 1435-§ 1444. POWERS OF DIRECTORS.

§ 1435. **In general.** — The powers of directors in the prosecution of the company's business are, broadly speaking, co-extensive with the powers of the company. Whatever the corporation may do, the directors may do for it. As already stated, directors are with respect to their powers closely analogous to managing partners. They may also be compared to the legislature of a state, which has all the powers of the people of the state except where limited by its constitution. So directors may lawfully exercise any power possessed by the company for the prosecution of its ordinary business, however serious or delicate it may be, unless it be expressly prohibited to them.⁴ Thus,

¹ *Marlborough Ass'n v. Peters, etc. Co.*, 70 Pac. 838; 72 Pac. 687; 179 Mass. 61; 60 N. E. 396.

² *Huguenot Nat. Bank v. Studwell*, 6 Daly (N. Y.) 13.

³ *Commonwealth v. Cullen*, 13 Pa. St. 133; 53 Am. Dec. 450; *Vandenberg v. Broadway Ry. Co.*, 29 Hun 348; *Speer v. Colbert*, 200 U. S. 130; 26 Sup. Ct. 201; *Brick & Stone Co.*, W. N. (1878) 140.

It has been held that there is no presumption that three persons who were the only shareholders and therefore the only persons qualified as directors were directors. *Grand Rapids Furniture Co. v. Grand Hotel*,

11 Wyo. 128. But cf. *supra*,

§ 1404.

⁴ *Park v. Grant Locomotive Works*, 40 N. J. Eq. 114; 3 Atl. 162; *Burrill v. Nahant Bank*, 2 Metc. (Mass.) 163; 35 Am. Dec. 395; *Wood v. Whelen*, 93 Ill. 153.

Cf. *Northampton Bank v. Pepoon*, 11 Mass. 288 (endorsing promissory note); *Metropolitan, etc. R. R. Co. v. Manhattan, etc. R. R. Co.*, 11 Daly (N. Y.) 373; *Collier v. Consolidated Ry., etc. Co.*, 57 Atl. 417; 70 N. J. Law 313; *Fillebrown v. Hayward*, 190 Mass. 472; 77 N. E. 45 (fixing

wherever the corporation has power to issue negotiable instruments, the directors may issue them on its behalf.¹ So directors may without any express authority levy a call upon shares subscribed for but not yet fully paid.² So too, they may allot unissued shares of the company's authorized capital, or may reissue shares which have been purchased or otherwise acquired by the company.³ They may gratuitously release a person against whom the company has a claim, in order to make him a competent witness on its behalf.⁴ They may settle or compromise disputed claims.⁵ They may mortgage the company's property,⁶ or execute leases thereof.⁷ They may on purchasing property on behalf of the company assume payment of a mortgage thereon as part of the purchase-price.⁸ They may publish in newspapers expensive advertisements containing information which they may deem important for the shareholders to possess.⁹ They may bind the company by committing an act of bankruptcy.¹⁰ If the business be proving unsuccessful, the directors may make a general assignment of the corporation's assets.¹¹ But they have been held

salary of treasurer); *Stark Bank v. U. S. Pottery Co.*, 34 Vt. 144 (holding that directors have no power to assume a debt of a third person except in case of "urgent necessity").

¹ *Peruvian Ry. Co.*, 2 Ch. 617.

² *Ambergate, etc. Ry. Co. v. Mitchell*, 4 Ex. 540; *Budd v. Multnomah Street Ry. Co.*, 15 Oreg. 413; 15 Pac. 659; 3 Am. Rep. 169.

³ *City Bank v. Bruce*, 17 N. Y. 507, 512 (headnote inadequate). Cf. *infra*, § 1436.

⁴ *Lewis v. Eastern Bank*, 32 Me. 90.

⁵ *Frankfort Bank v. Johnson*, 24 Me. 490; *Chambers v. Chambers & McKee*, 185 Pa. St. 105; 39 Atl. 822.

⁶ *Moran v. Strauss*, 6 Ben. 249; 17 Fed. Cas. 123; *Phinizy v. Augusta, etc. R. R. Co.*, 62 Fed. 678; *Wood v. Whelen*, 93 Ill. 153; *Thompson v. Natchez Water Co.*, 68 Miss. 423 (headnote inadequate); 9 So. 821; *Hendee v. Pinkerton*, 14 Allen (Mass.) 381 (issuing mortgage bonds).

⁷ *Mosher v. Sinnott*, 79 Pac. (Colo.) 742; *Beveridge v. N. Y. Elevated R. R. Co.*, 112 N. Y. 1; 19 N. E. 489; 2 L. R. A. 648.

⁸ *Beaver Knitting Mills*, 154 Fed. 320.

⁹ *Rascover v. American Linseed Co.*, 135 Fed. 341; 68 C. C. A. 11.

¹⁰ *Moench & Sons Co.*, 130 Fed. 685.

¹¹ *Reichwald v. Commercial Hotel Co.*, 106 Ill. 439; *Wright v. Lee*, 2 S. Dak. 596, 619-620; 51 N. W. 706; *Vanderpoel v. Gorman*, 140 N. Y. 563; 35 N. E. 932; 24 L. R. A. 548; 37 Am. St. Rep. 601; *Chamberlain v. Bromberg*, 83 Ala. 576; 3 So. 434; *Goetz v. Knie*, 103 Wis. 366; 79 N. W. 401; *Rogers v. Pell*, 154 N. Y. 518; 49 N. E. 75; *Boyn-ton v. Roe*, 114 Mich. 401; 72 N. W. 257; *Hutchinson v. Green*, 91 Mo. 367; 1 S. W. 853; *Buell v. Buckingham, etc. Co.*, 16 Iowa 284, 296 (headnote inadequate); 85 Am. Dec. 516; *Whiting v. Hovey*, 13 Ont. App. 7; *Dana v. Bank of U. S.*, 5 Watts & Serg. (Pa.) 223; *Birm-*

to have no power so to do unless the corporation is insolvent,¹ and, indeed, a sale of all the assets, except when necessary to pay debts, is apt to be held *ultra vires* of the corporation.² The directors, unless expressly restrained, have clear power to create a mortgage or other charge upon all the company's property wherever such a charge is within the power of the company.³ By some authorities, a sale of any portion of the company's property that is essential to its business has been declared to be beyond the powers of the directors;⁴ although ordinarily the directors have power to sell any property belonging to the corporation.⁵ *A fortiori*, directors have no right to surrender the franchises of their corporation.⁶ It has been said *obiter* that without authority from the shareholders, directors have no power to pledge or hypothecate the future earnings of the company.⁷

§ 1436. **Acting so as to bind Company after Expiration of Term of Office.** — The fact that the term of office of a board of directors is limited does not prevent them from taking action that may bind the company after their term of office shall have expired. Thus, directors are usually elected for a year, but they

ingham Drug Co. v. Freeman, 15 Tex. Civ. App. 451; 39 S. W. 626.

Cf. *Tripp v. Northwestern Nat. Bank*, 41 Minn. 400; 43 N. W. 60.

But see contra: *Bank Commissioners v. Bank of Brest*, Harr. Ch. (Mich.) 106 (overruled); *Epwright v. Nickerson*, 78 Mo. 482 (semble); *Kyle v. Wagner*, 45 W. Va. 349; 32 S. E. 213. As to institution of proceedings for the dissolution of the company, see *infra*, § 1438.

¹ *Powers v. Blue Grass Bldg. Ass'n*, 86 Fed. 705; *Abbot v. American Hard Rubber Co.*, 33 Barb. (N. Y.) 578; *Consolidated Water Power Co. v. Nash*, 109 Wisc. 490; 85 N. W. 485 (semble).

But see *Wilson v. Miers*, 10 C. B., n. s., 348. Cf. *Mercantile Library Hall Co. v. Pittsburgh Library Ass'n*, 173 Pa. St. 30; 33 Atl. 744; *De Camp v. Alward*, 52 Ind. 468; *Union Trust Co. v. Carter*, 139 Fed. 717, 730-731.

In *Ardesco Co. v. North Am., etc.*

Co., 66 Pa. St. 375, it was held that the directors of a mining company, which seems to have been solvent, might lease all of its property. Cf. *Hennesey v. Muhleman*, 40 N. Y. App. Div. 175; 57 N. Y. Supp. 854. But see *Metropolitan, etc. R. R. Co. v. Manhattan, etc. R. R. Co.*, 11 Daly (N. Y.) 373; *Cass v. Manchester, etc. Co.*, 9 Fed. 640.

² *Supra*, § 78.

³ *Marine Mansions Co.*, 4 Eq. 601.

⁴ *Rollins v. Clay*, 33 Me. 132; *Balliet v. Brown*, 103 Pa. St. 546 (semble).

⁵ *Lange v. Reservation Mining & Smelting Co.* (Wash.), 93 Pac. 208.

⁶ *Jones v. Bank of Leadville*, 10 Colo. 464; 17 Pac. 272.

Cf. *Smith v. Smith*, 3 Desaus. (S. Car.) 557.

⁷ *Brown v. Bradford*, 103 Iowa 378; 72 N. W. 648.

But see *Park v. Grant Locomotive Works*, 40 N. J. Eq. 114; 3 Atl. 162.

may, of course, enter into contracts that may bind the company long after the close of the year.¹ So, they may appoint agents with authority to act after they themselves shall have retired from office.²

§ 1437. **Regulations declaring that Directors shall have all the Powers of the Company.** — Sometimes express provision is made that the directors shall have all the powers of the company;³ but this seems merely declaratory. As presently to be explained, even under such a provision, the powers of the directors are limited to the ordinary business of the company.⁴

§ 1438-§ 1443. LIMITS OF POWERS OF DIRECTORS.

§ 1438. **Powers confined to regular Business of the Company and not extended to Alteration of its Constitution.** — Even where directors are expressly clothed with all the powers of the company, and *a fortiori* where there is no such provision, their powers extend only to the prosecution of the regular business of the corporation; they have no power or authority to alter its constitution.⁵

Thus, where the company is authorized to increase its capital stock, the directors have no power to issue the additional shares⁶

¹ *Usher v. New York Central, etc. R. R. Co.*, 76 N. Y. App. Div. 422; 78 N. Y. Supp. 508 (contract by directors of railway company to pay an employee a certain salary for life).

² *Kidd v. New Hampshire Traction Co.* (N. H.), 66 Atl. 127.

But see *Beers v. New York Life Ins. Co.*, 66 Hun 75; 20 N. Y. Supp. 788; *Davis v. Flagstaff Silver Mining Co.*, 2 Utah 74 (where it was said that neither the directors nor the corporation itself can create an irrevocable agency); *Carney v. New York Life Ins. Co.*, 57 N. Y. 78; 162 N. Y. 453; 49 L. R. A. 471; *Burkhead v. Independent School District*, 107 Iowa 29 (denying power of a school board to employ teacher for five years).

³ See *Railway Co. v. Allerton*, 18 Wall. 233; *Municipal Freehold Land Co. v. Pollington*, 63 L. T. 238; *Am-*

bergate, etc. Ry. Co. v. Mitchell, 4 Ex. 540; *Maine Mut., etc. Ins. Co. v. Neal*, 50 Me. 301; *Hendee v. Pinkerton*, 14 Allen (Mass.) 381.

⁴ *Infra*, § 1438.

⁵ Cf. *Blatchford v. Ross*, 54 Barb. (N. Y.) 42 (where the directors were expressly empowered to alter the constitution, but where the court confined the power within the narrowest possible limits); *Venner v. Atchison, etc. R. Co.*, 28 Fed. 581 (where the directors were invested by the charter with "all the corporate powers" of the company); *Clark v. Brown* (Tex.), 108 S. W. 421 (consolidating with another corporation).

⁶ *Railway Co. v. Allerton*, 18 Wall. 233; *Eidman v. Bowman*, 58 Ill. 444; 11 Am. Rep. 90.

Cf. *Marlborough Mfg. Co. v. Smith*, 2 Conn. 579; *Payson v. Stoeber*, 2 Dillon 427. See *Payson*

— the change must be passed upon by the shareholders; for the exercise of the power to increase the capital involves a radical change in the constitution of the company. *A fortiori*, where the power to make the increase is expressly given to the shareholders, it cannot be exercised by the directors.¹ But an issue of bonds by the directors is not invalidated because the bonds contain a provision purporting to make them convertible at the option of the holder into stock of the corporation;² at most, this provision alone is void. It has been held by an inferior court in New York that where a company has the privilege of redeeming or retiring its preferred stock, the directors are competent to exercise the option on its behalf,³ but inasmuch as such redemption works a reduction of capital — although under the circumstances of the case a lawful reduction — it is submitted that a different result might well have been reached. So, even where the company has power to purchase its own shares, the power cannot be exercised by the directors in the absence of a statute, by-law, or resolution of the shareholders authorizing them to do so.⁴

On the same principle of limiting directors' powers to the ordinary business of the company, it has been held that directors have no power to receive the resignation of one of their number,⁵ and while there is reason to doubt the correctness of this particular application of the principle, the principle itself is unsailable. It was once held by the New York Supreme Court, where a company was given power by a special act of the legis-

v. *Withers*, 5 Biss. 269, where the directors were expressly empowered to make the increase.

When once the increase of capital is in legal contemplation made, the allotment and issue of the new shares would seem to be within the powers of the directors just as the allotment and issue, or reissue, of shares of the original capital. See *supra*, § 1435.

¹ *McNulta v. Corn Belt Bank*, 164 Ill. 427; 45 N. E. 954; 56 Am. St. Rep. 203.

Cf. *Finley Shoe Co. v. Kurtz*, 34 Mich. 89.

² *Wood v. Whelen*, 93 Ill. 153.

³ *Hackett v. Northern Pac. Ry. Co.*, 36 N. Y. Misc. 583; 73 N. Y. Supp. 1087.

⁴ *Hastings Lumber Co. v. Edwards*, 75 N. E. 57; 188 Mass. 587. Cf. *Beaconsfield Heights Estate Co.*, 22 Vict. L. R. 97 (overruling, although not citing an earlier case in the same state, *Melbourne Locomotive & Engineering Works*, 21 Vict. L. R. 422, headnote inadequate); *Fuches v. Hamilton, etc. Pub. Co.*, 10 Ont. 497 (directors not empowered to enter into compromise of claim against shareholders for unpaid subscriptions).

⁵ *Supra*, § 1431.

lature to decrease the number of its directors, that the power of reduction might be exercised by the board of directors themselves;¹ but this decision conflicts with the principle of the cases above referred to, and its authority is, moreover, weakened by a forcible dissenting opinion.

Where a statute provides that a corporation whose capital has been impaired may either levy an assessment on the shareholders or go into liquidation, the shareholders and not the directors must make the decision.² So, the power to enact and amend by-laws resides in the shareholders and cannot be exercised by the directors.³ It has also been held that the directors have no power to dissolve the company or to initiate proceedings for its voluntary liquidation.⁴

§ 1439. *Acceptance of legislative Amendments to charter.* — With respect to directors' power to accept legislative amendments of the company's charter or act of incorporation, two questions are to be considered; first, whether the legislature intended that the amendment should become operative on its acceptance by the directors, and second, whether such intention can be constitutionally carried out against the opposition of the shareholders or any of them. As to the first of these questions, the answer is that presumptively the legislature should be taken to have contemplated acceptance of the amendment by the shareholders and not by the directors alone;⁵ but if enough appears to overthrow this presumption, the second question, which belongs to the domain of constitutional law and lies outside the scope of this work, will arise.

§ 1440-§ 1441. *Control of Shareholders over Directors.*

§ 1440. *In general.* — Another limitation on the powers of directors results from their subjection to the control of the shareholders. Even where the functions of directors are conferred upon them by statute, there is no legislative intention of

¹ *Excelsior Insurance Co.*, 38 Barb. 297.

⁴ *Standard Bank of Australia*, 24 Vict. L. R. 304.

² *Commercial Nat. Bank v. Weinhard*, 192 U. S. 243; 24 Sup. Ct. 253; *Hulitt v. Bell*, 85 Fed. 98.

⁵ See *Venner v. Atchison, etc. R. Co.*, 28 Fed. 581.

³ *Supra*, § 691, § 692.

But see *Dayton, etc. R. R. Co. v. Hatch*, 1 Disney (Oh.) 84.

relieving them from the control of the shareholders.¹ For, the shareholders are the proprietors of the corporation, and it is or should be the policy of the law to give them the fullest measure of control over their own property, so far as compatible with the public welfare. Accordingly, the directors have no right to violate a resolution of the shareholders prescribing the policy to be pursued by the company.² It would seem equally clear on principle that the shareholders may lawfully take into their own hands the most minute details of the company's business.³ For instance, the shareholders may appoint an agent whose authority shall not be revocable by the directors.⁴ So, the shareholders may authorize or ratify a business contract although the same has never been approved by the directors, and this is true although by statute certain members of the board of directors were appointed by the government.⁵ If it be objected that the minutiae of business are best intrusted to a small board rather than to a disorderly mob, of which a shareholders' meeting is often composed, the answer is that the shareholders are the persons whose interests are at stake and that they are therefore the judges of such considerations. If it be further objected that the directorate is the body constituted by law to deal with such matters, the reply is that the law should not be deemed to have

¹ See *supra*, § 1191. Cf. *Griffing Iron Co.*, 63 N. J. Law 168, 172 (headnote inadequate); 41 Atl. 931; affirmed 63 N. J. Law 357; 46 Atl. 1097.

² *Pender v. Lushington*, 6 Ch. D. 70. Cf. *Cass v. Manchester, etc. Co.*, 9 Fed. 640.

³ In addition to cases cited below, see *Manhattan Brass Co. v. Webster*, 37 Mo. App. 145, 154-155; *Garmany v. Lawton*, 124 Ga. 876; 53 S. E. 669 (where the directors, if any existed, were entirely inactive).

⁴ *Smith v. Wells Mfg. Co.*, 148 Ind. 333, 343; 46 N. E. 1000.

But cf. *Charlestown Boot, etc. Co. v. Dunsmore*, 60 N. H. 85 (where it was said that the shareholders had no power to appoint an agent to act with the directors); *Great Central Freehold Mines v. Brandon*, 30 Vict. L. R. 97 (holding that a majority of

the shareholders in case of a voluntary winding-up have no power to take the management out of the hands of the liquidators and place it in the hands of a liquidator appointed by the shareholders).

⁵ *Union Pac. Ry. Co. v. Chicago, etc. Ry. Co.*, 163 U. S. 564, 595-600 (headnote inadequate); 16 Sup. Ct. 1173. *Fuller, C. J.*, said, "When by the charter of a corporation its powers are vested in the stockholders, and this was the common law rule when the charter was silent, the ultimate determination of the management of the corporate affairs rests with the stockholders, and the charter of the Pacific Company did not commit the exclusive control to the board of directors." 163 U. S. 596. Cf. *Caho v. Norfolk, etc. Ry. Co.* (N. Car.), 60 S. E. 640.

deprived the shareholders of control over the management of their own property. These objections, however, which an attempt has just been made to refute have prevailed with some American courts,¹ and have recently received considerable support in an English case,² and in a Canadian case.³ In line with the doctrine advocated above, it has been said that, even where the continuing directors are expressly empowered to fill casual vacancies in the board, still the shareholders may themselves fill any such vacancy existing at the time of a general meeting.⁴

§ 1441. **Provisions in Charter, Incorporation Paper or other Regulations restraining the Shareholders from controlling the Directors.** — In exercising this power of supervision over the directors, the shareholders cannot alter the constitution of the company except by observing the forms prescribed by law for that purpose. Thus, where the charter of the company provides that the company's by-laws should be amendable only at a general meeting convened in pursuance of public notice by advertisement in newspapers published in two counties, the shareholders at a meeting convened without such notice passed a resolution diminishing the mileage to which under the by-laws the directors were entitled. This resolution being invalid as an amendment to the by-laws could not control the directors as a mere expression of desire on the part of the shareholders.⁵ So,

¹ *McCullough v. Moss*, 5 Denio (N. Y.) 567, 575; *Conro v. Port Henry Iron Co.*, 12 Barb. 27, 62-63; *Gashwiler v. Willis*, 33 Cal. 11; *Walamet Falls Co. v. Kittredge*, 5 Sawy. 44; *United Gold Mining Co. v. Rocky Mountain Nat. Bank*, 2 Colo. 565, 575; *Insurance Bank v. Bank of U. S.*, 4 Clark (Pa.) 125; *Stoeckle v. Hahn*, 158 Ill. 79; 42 N. E. 150.

In *Colorado Springs Co. v. American Publishing Co.*, 97 Fed. 843; 38 C. C. A. 433, the court said that the shareholders as distinguished from the directors have no power to make or ratify a sale of the company's assets unless all the shareholders are present and concur — a unique distinction.

It has often been said that directors do not derive their powers from

the shareholders but from the charter. See *Lexington, etc. Ins. Co. v. Page*, 17 B. Monr. 412, 439 Ky. (headnote inadequate); 66 Am. Dec. 165; and cases cited above. But under modern general incorporation laws, the charter or incorporation paper derives its efficacy from the shareholders and therefore the directors do mediate derive their powers from the shareholders.

² *Automatic Self-Cleaning Filter Syndicate Co. v. Cunningham* (1906), 2 Ch. 34.

³ *Dunsmuir v. Colonist Printing & Pub. Co.*, 9 Brit. Columb. 290.

⁴ *Munster v. Cammell Co.*, 21 Ch. D. 183.

Cf. *Isle of Wight Ry. Co. v. Tabor*, 25 Ch. D. 320, 333, 335, 336.

⁵ *Mutual Fire Ins. Co. v. Far-*

where the company's incorporation paper provides that the directors named therein shall have exclusive control of the company for a term of years during which time no shareholders' meeting is to be held, except to act in an advisory capacity to the directors, the shareholders cannot during that period convene a meeting and control the action of the company.¹ So, where the articles of association of an English company vested full power of control in the directors "subject to such regulations . . . as may from time to time be made by extraordinary resolution," the Court of Appeal held that the directors were not obliged to obey a simple resolution of the shareholders not passed as an extraordinary resolution, ordering that a certain sale of the company's property should be made.² The will of the shareholders expressed by a resolution binds the directors only where such will does not run counter to the constitution of the company.

§ 1442. **Effect of Directors' wrongful Failure to convene Meeting of Shareholders.** — Since the directors are subject to the control of the shareholders, the temptation may sometimes be strong to postpone unduly the holding of a general meeting, and thus prevent interference with their management.³ Such conduct is certainly reprehensible, and in a clear case may be enjoined by a court of equity;⁴ or the duty to convene a general meeting may be enforced by mandamus.⁵ Yet, if the directors have perpetrated the wrong, and in order to consummate their own schemes have omitted to call a shareholders' meeting at the

quhar, 86 Md. 668; 39 Atl. 527. But cf. *Harben v. Phillips*, 23 Ch. D. 14.

¹ *Union Trust Co. v. Carter*, 139 Fed. 717. As to the validity of such a provision in an incorporation paper, see *supra*, § 122.

² *Automatic Self-Cleaning Filter Syndicate Co. v. Cunningham* (1906), 2 Ch. 34. Cf. *Dunsmuir v. Colonist Printing & Pub. Co.*, 9 Brit. Columb. 290.

³ Cf. *Bartlett v. Gates*, 118 Fed. 66.

⁴ *Elkins v. Camden, etc. R. R. Co.*,

36 N. J. Eq. 467, where the directors were enjoined from keeping themselves in office for several months by postponing the annual meeting for the election of their successors. Such misconduct may constitute cause for dissolution of the company; *Ward v. Sea Ins. Co.*, 7 Paige (N. Y.) 294.

⁵ *Mottu v. Primrose*, 23 Md. 482, where the facts were very similar to those in *Elkins v. Camden, etc. R. R. Co.*, stated in last preceding note.

time appointed by the company's regulations, their powers as directors do not cease because of that misconduct.¹

§ 1443. **Powers specially reposed in Shareholders at Large by Constitution of the Company.** — Of course, any special powers conferred by statute on the shareholders or company at large cannot be exercised by the directors.² Thus, where by statute a power of levying assessments on the shareholders was reposed in the corporation, Judge Story held that the power could not be exercised by the directors even if delegated to them by the shareholders.³ As this case was decided before the modern law of corporations was developed, less hesitancy need be felt in criticising it than would be ordinarily fitting in view of the eminence of the judge by whom it was pronounced. Accordingly, it is submitted that a statute reposing a power in the corporation as a whole, but not expressly in the shareholders at large, should not be taken to deny the right of the directors to exercise it, unless indeed the power relates to alterations in the constitution of the company.

§ 1444. **Delegation of Powers by Shareholders to Directors.** — The power of the shareholders by resolution to enlarge the powers of the directors and to confer upon them powers specially confided by the constitution of the company to the shareholders themselves is considered elsewhere.⁴

§ 1445-§ 1488. MODE OF ACTION BY DIRECTORS.

§ 1445. **Scheme of Treatment.** — In considering the subject of the manner of exercise of directors' powers, one should first investigate the question what mode of action is regular and formal, leaving for subsequent consideration the question how far departure from rule is fatal to the validity of the action taken.

¹ *Anglo-Universal Bank v. Baragon*, 45 L. T. 362. As to this case, see also *supra*, § 1192. Cf. *Rives v. Montgomery South*

² Cf. *Louisiana Paper Co. v. Plank Road Co.*, 30 Ala. 92, 97 (where the Winsor case is distinguished).

³ *Ex parte Winsor*, 3 Story 411. ⁴ See *supra*, § 1192.

§ 1446-§1469. WHAT MODE OF ACTION BY DIRECTORS IS REGULAR.

§ 1446. **Directors without Power to Act except as a Board.** — Directors are agents of the corporation for the management of its business, and the law of agency is therefore applicable to them in all its scope. They are differentiated from ordinary agents chiefly by the fact that the board of directors taken collectively are agents, but that each individual director is not *virtute officii* an agent of the corporation, and has no power to bind it.¹ Of course, one or more directors may be specially clothed with authority to act for and represent the company;² and such authority may be implied as well as express, but it cannot be inferred, even *prima facie*, merely from holding the office.³ Hence, a corporation cannot be liable for the fraud of its directors, who are also directors of another company, in deliberately mismanaging and wrecking the latter concern;⁴ for those wrongs are committed by them as a board of the latter company and not as agents of the former. So, admissions made by individual directors, not at a board meeting nor in the presence of their colleagues, are not admissible against the company.⁵

¹ *Limer v. Traders Co.*, 44 W. Va. 175; 28 S. E. 730; *Stoystown, etc. Co. v. Craver*, 45 Pa. St. 386; *Allemong v. Simmons*, 124 Ind. 199; 23 N. E. 768; *Peirce v. Morse-Oliver Bldg. Co.*, 94 Me. 406; 47 Atl. 914; *New Boston Fire Ins. Co. v. Upton*, 67 N. H. 469; 36 Atl. 366; *Monroe Mercantile Co. v. Arnold*, 108 Ga. 449; 34 S. E. 176; *Shoknecht v. Milwaukee Brick, etc. Co.*, 108 Wisc. 457; 84 N. W. 838 (fraudulent misrepresentation by one director); *Sias v. Consolidated Lighting Co.*, 73 Vt. 35; 50 Atl. 554; *Dockstader v. Y. M. C. A. (Iowa)*, 109 N. W. 906; *Guillaume v. K. S. D. Fruit Land Co. (Oreg.)*, 86 Pac. 883 (semble); *Clement v. Young-McShea Amusement Co. (N. J.)*, 67 Atl. 82.

But see *Huntington Fuel Co.*

v. McIlwaine (Ind.), 82 N. E. 1001.

² See *Robinson Reduction Co. v. Johnson*, 10 Colo. App. 135; 50 Pac. 215; *Remington Paper Co. v. London Ass. Co.*, 12 N. Y. App. Div. 218; 43 N. Y. Supp. 431.

³ *Morrison v. Wilder Gas Co.*, 91 Me. 492; 40 Atl. 542; 64 Am. St. Rep. 257; *Shoknecht v. Milwaukee Brick, etc. Co.*, 108 Wisc. 457, 465; 84 N. W. 838; *Wagner v. St. Peter's Hospital*, 32 Mont. 206; 79 Pac. 1054.

⁴ *Fitzgerald v. Fitzgerald, etc. Mallory Co.*, 44 Nebr. 463; 62 N. W. 899. See, to substantially the same effect, *infra*, § 1582.

⁵ *Stoystown, etc. Co. v. Craver*, 45 Pa. St. 386.

§ 1447-§ 1462. BOARD MEETINGS.

§ 1447. **In general.** — Ordinarily, then, if not universally, the action of directors, *qua* directors, in order to be regular should be through the medium of a board meeting, although, as we shall presently see, action taken without a board meeting is perhaps not necessarily wholly irregular. What then is necessary to constitute a directors' meeting?

It may be premised that board meetings may without impropriety be conducted in an informal way. Certainly they need not be governed by parliamentary law or usage. They are more analogous to a cabinet meeting than to a legislative assembly. For example, without vitiating the meeting, if not without irregularity, the same person may act both as president and secretary.¹

§ 1448. **By whom Meeting may be called.** — In default of other provision in the regulations or by-laws of the company, it would seem that any member of the board may issue a call for a special meeting.² Where the regulations provide that the president shall call the meetings it has been said that no one else can lawfully do so;³ but on principle it would seem only reasonable that such provisions should be construed as directory merely.⁴ Meetings specially convened are not impliedly prohibited by provisions for the holding of regular or stated meetings.⁵

§ 1449-§ 1454. *Notice of Meeting.*

§ 1449. **Of what Meetings Notice must be given.** — Of every special meeting, notice must in general be given to each director in order that all may have an opportunity to attend and participate therein.⁶ Of an adjourned meeting, notice to all the directors is not required,⁷ unless the resolution to adjourn omits

¹ *Budd v. Walla Walla, etc. Pub. Co.*, 2 Wash. Ty. 347; 7 Pac. 896.

² Cf. *United Growers Co. v. Eisner*, 22 N. Y. App. Div. 1, 5; 47 N. Y. Supp. 906.

³ *Hill v. Rich Hill, etc. Co.*, 119 Mo. 9, 26; 24 S. W. 223; *Smith v. Dorn*, 96 Cal. 73; 30 Pac. 1024.

⁴ Cf. *Troy Mining Co. v. White*, 10 S. Dak. 475, 480 et seq.; 74 N. W. 236; 42 L. R. A. 549.

As to when the vice-president

may act instead of the president, see *Bell v. Standard Quicksilver Co.*, 146 Cal. 699; 81 Pac. 17.

⁵ *United Growers Co. v. Eisner*, 22 N. Y. App. Div. 1, 5; 47 N. Y. Supp. 906; *Read v. Memphis Gas Co.*, 9 Heisk (Tenn.) 545.

⁶ See cases collected *infra*, § 1461, § 1463.

⁷ *Wills v. Murray*, 4 Ex. 843; *Smith v. Law*, 21 N. Y. 296; *Western Imp. Co. v. Des Moines Nat.*

to specify the precise time for the adjourned session;¹ the directors are charged with notice of what was done at the original meeting. Also, notice is not required of a stated meeting the time and place of which have been fixed either by the company's by-laws or regulations² or by custom.³

§ 1450. **By-law or Custom dispensing with Notice.**— It has been held that an established custom of directors to transact business whenever during business hours a majority may assemble at the company's office dispenses with the necessity for notice.⁴ This decision enables the directors by a mere custom to deprive the company of its right that all its directors shall have the opportunity to be heard on any question. Nevertheless as a custom of a corporation may have the effect of a by-law, the decision is probably sound. For, a by-law obviating the necessity of notice is probably valid.⁵ Certainly, a by-law dispensing with any notice when all the directors attend would be effective, and indeed as we shall see below such a by-law is merely declaratory of the common-law rule. Any such by-law would apply, however, only when all the directors consent to have a meeting, and would not enable the majority to go to the bedroom of an ill colleague and force a meeting on him then and there.⁶

§ 1451. **Who are entitled to Notice.**— Where one of the directors, on being informed of an intention to hold a meeting during the following week, stated that he would be unable to attend, that circumstance does not amount to a waiver of notice, or excuse the failure to notify him of the precise time of the meeting.⁷ There is no rigid rule of law that notice need not be given to a director who is absent from the country;⁸ indeed,

Bank, 103 Iowa 455; 72 N. W. 657.

But see *Bank of National City v. Johnston*, 133 Cal. 185; 65 Pac. 383. Cf. *Whitehead v. Hamilton Rubber Co.*, 52 N. J. Eq. 78; 27 Atl. 897; *McLaren v. Fischen*, 28 Grant (Can.) 352 (where the original meeting was not attended by a quorum).

¹ *Thompson v. Williams*, 76 Cal. 153; 18 Pac. 153; 9 Am. St. Rep. 187.

² *Smith v. Law*, 21 N. Y. 296; *Gumaer v. Cripple Creek, etc. Co.* (Colo.), 90 Pac. 81.

³ *Atlantic Fire Ins. Co. v. Sanders*, 36 N. H. 252, 269.

⁴ *American Exchange Bank v. First Nat. Bank*, 82 Fed. 961, 973-974; 27 C. C. A. 274. See also *infra*, § 1464.

⁵ Cf. *supra*, § 122.

⁶ *State ex rel. Grimm v. Manhattan Rubber Co.*, 149 Mo. 181; 50 S. W. 321.

⁷ *Portuguese Consolidated Mines*, 42 Ch. D. 160.

⁸ *Halifax Sugar Refining Co. v. Francklyn*, 59 L. J. Ch. 591 (semble). Cf. *Portuguese Consolidated Mines*,

any such rule would be attended with very serious consequences in the United States where a majority of the directors often reside in a different State from that under whose laws the company is organized. In each case, it is a question of reasonableness; and therefore it has been held that notice need not be sent to a director of an English corporation who is absent in America,¹ nor to directors of a Connecticut company who are in Montana and South Carolina respectively.² Generally, as *lex non cogit ad impossibilia*, where notice to a certain director is for any other reason totally impracticable, the want thereof will be excused.³ And it has been declared that notice need not be given to a director who is disqualified by interest from taking part in the subject of the meeting.⁴ It may be doubted whether notice need be given to a director who is prevented by illness from attending to business.⁵ One who has been elected a director but who has not yet accepted the office need not be notified.⁶ It seems also that notice need not be given to one who is merely a nominal director and shareholder, and who although aware that the other members of the board are managing the company without notifying him, yet raises no objection.⁷ Lack of notice may be waived by attendance at the

42 Ch. D. 160 (where a director of an English company who was temporarily in Ireland was held entitled to notice); *Farwell v. Houghton Copper Works*, 8 Fed. 66, 69 (where a director "temporarily absent from the State" was held necessary to be notified); *Bank of Little Rock v. McCarthy*, 55 Ark. 473; 18 S. W. 759; 29 Am. St. Rep. 60; *Nat. Bank of Commerce v. Shumway*, 49 Kans. 224; 30 Pac. 411; *Covert v. Rogers*, 38 Mich. 363; 31 Am. Rep. 319; *Porter v. Robinson*, 30 Hun (N. Y.) 209.

¹ *Halifax Sugar Refining Co. v. Francklyn*, 59 L. J. Ch. 591.

Cf. *Jones v. Morrison*, 31 Minn. 140, 149-150; 16 N. W. 854; *Brown v. Republican, etc. Co.*, 55 Fed. 7.

² *Chase v. Tuttle*, 55 Conn. 455; 12 Atl. 874; 3 Am. St. Rep. 64.

Cf. *Nat. Bank of Commerce v. Shumway*, 49 Kans. 224; 30 Pac.

411; *Taylor v. R. D. Scott & Co.* (Mich.), 113 N. W. 32, 33 (one director absent in the Philippines).

³ *Singer v. Salt Lake, etc. Mfg. Co.*, 17 Utah 143; 53 Pac. 1024; 70 Am. St. Rep. 773 (semble). Cf. *Stafford Spring Street Ry. Co. v. Middle River Mfg. Co.* (Conn.), 66 Atl. 775.

⁴ *Troy Mining Co. v. White*, 10 S. Dak. 475; 74 N. W. 236; 42 L. R. A. 549.

⁵ *Corbett v. Woodward*, 5 Sawy. 403, 412 (headnote inadequate); *Troy Mining Co. v. White*, 10 S. Dak. 475, 480 (headnote inadequate); 74 N. W. 236; 42 L. R. A. 549.

⁶ *United Growers Co. v. Eisner*, 22 N. Y. App. Div. 1, 6 (headnote inadequate); 47 N. Y. Supp. 906; *Whittaker v. Amwell Nat. Bank*, 52 N. J. Eq. 400; 29 Atl. 203.

⁷ *Stiwell v. Webb Press Co.* (Ark.), 94 S. W. 915.

meeting;¹ or indeed, it seems, by concurrence in the action of the meeting *ex post facto*.²

§ 1452. **What Kind of Notice is good.**—It seems that notice left in due time at a director's place of business is sufficient although in point of fact it was never received,³ but the contrary has been held as to a notice left at a director's residence from which he was known to be temporarily absent.⁴ Notice by public post is sufficient if actually received, and the receipt will be presumed in the absence of proof to the contrary.⁵ Where a particular kind of notice is prescribed by the by-laws or regulations, no other notice would be regular.⁶ The notice need not specify the business to be transacted, however unusual and however important it may be;⁷ but a notice that is misleading as to the business intended to be transacted may render the meeting invalid.⁸ It has been held, however, that if all the shareholders are directors, a meeting called as a meeting of shareholder may properly act as a meeting of the board of directors.⁹

§ 1453. **Length of Notice required.**—As to the length of notice, no rule can be prescribed except that a reasonable time should be given to enable the several members to arrange to attend. Whether the length of notice given is reasonable would depend upon the nature of the company's business and upon the

¹ See *infra*, § 1465.

² *Stafford Springs Street Ry. Co. v. Middle River Mfg. Co.* (Conn.), 66 Atl. 775 (where the directors who were not notified signed a "waiver" of notice after the meeting).

³ *Corbett v. Woodward*, 5 Sawy. 403, 412 (headnote inadequate).

⁴ *Bank of Little Rock v. McCarthy*, 55 Ark. 473; 18 S. W. 759; 29 Am. St. Rep. 60.

⁵ *People v. Albany Med. College*, 26 Hun 348, affirmed in 89 N. Y. 635; *Ashley Wire Co. v. Illinois Steel Co.*, 164 Ill. 149; 45 N. E. 410; 56 Am. St. Rep. 187; *Stockton, etc. Works v. Houser*, 109 Cal. 1; 41 Pac. 809.

⁶ *People ex rel. Stephens v. Greenwood Lake Ass'n*, 18 N. Y. Supp. 491 (notice in writing required). Cf. *supra*, § 1201.

But see *Samuel v. Holladay*, 1 Woolwich 400, 409.

⁷ *La Compagnie de Mayville v. Whitley* (1896), 1 Ch. 788; *Bell v. Standard Quicksilver Co.*, 146 Cal. 699; 81 Pac. 17.

Cf. *London, etc. Society*, 31 Ch. D. 223; *Argus Co.*, 138 N. Y. 557, 578-579; 34 N. E. 388; *Whitehead v. Hamilton Rubber Co.*, 52 N. J. Eq. 78; 27 Atl. 897; *Savings Bank v. Davis*, 8 Conn. 192; *Ashley Wire Co. v. Illinois Steel Co.*, 164 Ill. 149; 45 N. E. 410; 56 Am. St. Rep. 187.

⁸ *Mercantile Library Hall Co. v. Pittsburgh Library Ass'n*, 173 Pa. St. 30; 33 Atl. 744.

⁹ *Manufacturers Exhibition Bldg. Co. v. Landay*, 76 N. E. 146; 219 Ill. 168.

places of residence of the directors. Thus, much shorter notice would be sufficient in the case of a small manufacturing concern all of whose directors reside in the same town than in the case of a great railway company whose directors are scattered from one end of the country to the other. So too, something would depend on the custom of the company in respect to the matter; for custom often has the force of a by-law. Two days' notice has been held sufficient,¹ but notice left at a director's office at eleven o'clock of a meeting to be held at two o'clock on the same day is not good, especially where it was not received until after the meeting had been held.² In Pennsylvania, the rule has been judicially declared that at least one clear day's notice is necessary unless a shorter notice is allowed by custom or the company's regulations.³ Of course the day and hour selected for the meeting must be reasonable; the meeting should not be called for Sunday or a holiday or for an unreasonable hour of the day.

§ 1454. **Presumption of Notice.**—The presumption always is in favor of regularity of action; and therefore in order to invalidate a meeting it is not enough that notice does not affirmatively appear to have been given to absent members, — want of notice must be established by proof.⁴ Where, however, the meet-

¹ *La Compagnie de Mayville v. Copper Mfg. Co.*, 17 Utah 143; 53 Pac. 1024; 70 Am. St. Rep. 773; *Whitley* (1896), 1 Ch. 788.

Cf. *John Morley Bldg. Co. v. Barras* (1891), 2 Ch. 386.

² *Homer Gold Mines*, 39 Ch. D. 546.

See, however, *Argus Co.*, 138 N.Y. 557, 577-579; 34 N. E. 388, where notice given in the morning for a meeting in the evening of the same day was upheld without objection on the score of its brevity.

See also *Covert v. Rogers*, 38 Mich. 363; 31 Am. Rep. 319.

³ *Mercantile Library Hall Co. v. Pittsburgh Library Ass'n*, 173 Pa. St. 30; 33 Atl. 744.

⁴ *Sargent v. Webster*, 13 Metc. (Mass.) 497; 46 Am. Dec. 743; *Wells v. Rodgers*, 60 Mich. 525; 27 N. W. 671; *Penobscot, etc. R. R. Co. v. Dunn*, 30 Me. 587, 600 (headnote inadequate); *Chase v. Tuttle*, 55 Conn. 455, 468; 12 Atl. 874; 3 Am. St. Rep. 64; *Singer v. Salt Lake*

Copper Mfg. Co., 17 Utah 143; 53 Pac. 1024; 70 Am. St. Rep. 773; *Choutteau Ins. Co. v. Holmes's Adm'r*, 68 Mo. 601; 30 Am. Rep. 807; *Leavitt v. Oxford, etc. Co.*, 3 Utah 265; 1 Pac. 356; *Hardin v. Iowa Ry., etc. Co.*, 78 Iowa 726; 43 N. W. 543; 6 L. R. A. 52; *Lane v. Brainerd*, 30 Conn. 565; *Barrell v. Lake View Land Co.*, 122 Cal. 129; 54 Pac. 594; *Balfour-Guthrie Co. v. Woodworth*, 124 Cal. 169; 56 Pac. 891; *Boynnton v. Roe*, 114 Mich. 401; 72 N. W. 257 (a strong case); *Budd v. Walla Walla, etc. Pub. Co.*, 2 Wash. Ty. 347; 7 Pac. 896; *Mills v. Boyle Mining Co.*, 132 Cal. 95; 64 Pac. 122; *Turner v. Fidelity Loan Concern* (Cal.), 83 Pac. 62; *Robinson v. Blood* (Cal.), 91 Pac. 258.

Cf. *Waite v. Windham, etc. Co.*, 37 Vt. 608; *Stockton, etc. Works v. Houser*, 109 Cal. 1; 41 Pac. 809; *Whittington v. Farmers' Bank*, 5 H. & J. (Md.) 489.

ing is held at an unusual place and no record or minutes thereof are produced, the presumption is rebutted, and the burden of proving due notice of the meeting then rests on those who assert its validity.¹

§ 1455. **Quorum.** — It seems that at least two persons are necessary to constitute any *meeting*.² But the modern English authorities are not entirely clear upon the point how many directors are *prima facie* necessary to make a quorum of the board. Lord Romilly stated the rule as follows:³ “They (the articles of association) nowhere specify what number shall form a quorum of directors. It is suggested that, in the absence of any stipulation to that effect, it requires the total number to be present. But I do not think that follows; I think that what does follow is this, that it is the duty of the court to find out what was the usual number of directors who conducted the business of the company. I find the usual number was two.” Accordingly, the learned judge held that two directors out of six were a sufficient quorum. But Lord Romilly’s rule would be of no assistance where no custom has been established in respect to the number of directors attending meetings.

The American authorities are quite clear that in the absence of express provision a majority of the board of directors is at common law necessary and sufficient as a quorum for the transaction of business.⁴ The American rule is historically sound, being supported by the rule of the common law in respect to royal charter corporations, that where a corporate body or board consists of a definite number, a majority of that number must meet in order to constitute a quorum.⁵ Some English authorities

¹ *First Nat. Bank v. Asheville, etc. Lumber Co.*, 116 N. Car. 827; 21 S. E. 948. *wood v. Mechanics Nat. Bank*, 9 R. I. 308; 11 Am. Rep. 253; *Hax v. Davis Mill Co.*, 39 Mo. App. 453;

² *Sharp v. Dawes*, 2 Q. B. D. 26. *Price v. Grand Rapids, etc. R. R. Co.*, 13 Ind. 58; *Silsby v. Strong*, 62 Pac.

³ *Lyster’s Case*, 4 Eq. 233, 237. ⁴ *Sargent v. Webster*, 13 Metc. 633; 38 Oreg. 36; *St. Louis Colonization Ass’n v. Hennessy*, 11 Mo. (Mass.) 497; 46 Am. Dec. 743; *Ex parte Willcocks*, 7 Cow. (N. Y.) 402; App. 555, 560.

17 Am. Dec. 525; *Craig v. First Presbyterian Church*, 88 Pa. St. 42; 32 Am. Rep. 417 (semble); *Lock-* ⁵ *Hascard v. Somany, Freem.* 504; *Grant on Corporations*, 68.

agree with the American cases in applying this same rule to directors of modern incorporated companies.¹

This rule is not altered by a statutory provision that a majority of those present at any regular meeting shall be competent to act; for, unless a majority of the board attend, the meeting is not, at least according to the American view, "a regular meeting."² However, a by-law providing that a number less than a majority of the board shall be a quorum is valid;³ and *a fortiori*, the same is true of a by-law providing that three directors, being less than a quorum, shall have power to adjourn to some future fixed date, so that the adjourned meeting, if attended by a quorum, may legally exercise the powers of the board although the absentee members had no notice of the adjourned meeting.⁴

Where a statute makes a majority a quorum, a majority of the full board is meant, and not merely a majority of the board as reduced by casual vacancies.⁵ Directors cannot vote by proxy,⁶ and therefore a director who is present only by proxy cannot be reckoned in counting a quorum;⁷ nor may a director be counted who for any reason is disqualified from voting—for example, a director who is disqualified because of an individual interest in the subject of the meeting.⁸ But, of course, a director who was present may be counted to make a quorum,

¹ *Howbeach Coal Co. v. Teague*, 5 H. & N. 151; 1 Lindley on Companies, 6th ed., 209. But see *Lyon's Case*, 35 Beav. 646. As to whether when there are four directors, two can be competent as a quorum, compare, *Steele's Case*, 1 Megone 246.

² *Ex parte Willcocks*, 7 Cow. (N. Y.) 402; 17 Am. Dec. 525.

³ *Hoyt v. Thompson's Ex'r*, 19 N. Y. 207. As to usage to the same effect, see *Hascard v. Somany*, Freem. 504. Cf. *infra*, § 1464, and *supra*, § 1450.

⁴ *Smith v. Law*, 21 N. Y. 296.

⁵ *Porter v. Lassen, etc. Co.*, 127 Cal. 261, 270; 59 Pac. 563 (semble).

⁶ *Infra*, § 1458.

⁷ *Ohio Valley Nat. Bank v. Walton Architectural Iron Co.*, 30 Wkly. Law Bull. (Oh.) 382.

⁸ *Greymouth Point, etc. Coal Co.* (1904), 1 Ch. 32; *Butts v. Wood*, 37 N. Y. 317; *Curtin v. Salmon River, etc. Co.*, 130 Cal. 345; 62 Pac. 552; 80 Am. St. Rep. 132; *Bassett v. Fairchild*, 132 Cal. 637; 64 Pac. 1082; 52 L. R. A. 611; *Waite v. Windham, etc. Mining Co.*, 36 Vt. 18; *Van Hook v. Somerville Mfg. Co.*, 5 N. J. Eq. (1 Halst.) 137, 169; *Leary v. Interstate Nat. Bank*, 63 S. W. Rep. 149 (Tex.); *San Antonio Street Ry. Co. v. Adams*, 87 Tex. 125, 131-132 (headnote inadequate); 26 S. W. 1040; *Paxton v. Heron* (Colo.), 92 Pac. 15; *Triplett v. Fauver*, 103 Va. 123, 127; 48 S. E. 875; *Parsons v. Tacoma Smelting, etc. Co.* (Wash.), 65 Pac. 765; 25 Wash. 492.

But see *Gumaer v. Cripple Creek, etc. Co.* (Colo.), 90 Pac. 81.

although he was acting under some mistake or misapprehension.¹ The president of the company, when he is also a director, may be counted for the purpose of making a quorum;² but his presence is not indispensable at a board meeting any more than that of any other single director.³ A provision that "six directors including the president" shall constitute a quorum means merely that the president is to be reckoned as a director in counting a quorum and does not make his presence indispensable to a valid meeting.⁴

It has been held that, if the number of directors is reduced below a quorum by death or otherwise, the continuing members have no power to act.⁵

It has been held in Canada that a meeting attended by less than a quorum has no power to adjourn the meeting to a fixed time and a different place.⁶

The presence of a quorum at any meeting at which business is transacted should be presumed in the absence of evidence to the contrary.⁷

§ 1456. **Effect of Vacancies in Board.** — *Reduction in Number of Directors below legal Minimum.* — Where a minimum number of directors is fixed by statute or the company's regulations, the provision is mandatory, so that if the total number fall below such minimum, no valid board meeting can be held although the prescribed quorum may attend. Thus, a company's articles provided that the number of directors should be not less than five and that the quorum should be determined by the directors, who subsequently fixed it at three; by death and bankruptcy, the number of directors was reduced to four: but the court held that a meeting attended by all four, although more than the prescribed quorum of three, was incompetent to

¹ *Franklin Bank v. Johnson*, 24 Me. 490, 504-505 (headnote inadequate).

² *Bank of Md. v. Ruff*, 7 G. & J. (Md.) 448.

³ *Sargent v. Webster*, 13 Mete. (Mass.) 497; 46 Am. Dec. 743.

Cf. *Meyer v. Johnson*, 53 Ala. 237.

⁴ *Meyer v. Johnson*, 53 Ala. 237, 321-323.

⁵ *Sovereign, etc. Co. v. Whitside*, 12 Ont. L. R. 638.

⁶ *McLaren v. Fiskien*, 28 Grant (Can.) 352.

⁷ *Baile v. Calvert College, etc. Ass'n*, 47 Md. 117. Cf. *Whittington v. Farmers Bank*, 5 H. & J. (Md.) 489; *Van Hook v. Somerville Mfg. Co.*, 5 N. J. Eq. (1 Halst.) 137 (where any presumption of regularity was rebutted and where the court thought that a non-resident director should be presumed to be absent).

transact any business.¹ But where it is provided that the continuing members of the board may act in spite of any vacancy, they may act although the vacancy reduces their number below the prescribed minimum.² Of course, the mere fact of a vacancy existing in the board does not prevent the continuing members from acting, provided they be a quorum and not less than any number fixed as the legal minimum of the board.³

§ 1457-§ 1460. *Voting at Board Meetings — Number of Votes necessary to determine Action of Meeting.*

§ 1457. **In general — Sufficiency of Majority Vote.** — A majority of the directors present at any meeting, provided a quorum be in attendance, is sufficient to decide any question upon which the meeting may act.⁴ Hence, an allegation in a pleading that certain action was taken by the board is supported by proof that it was taken by a majority at a board meeting;⁵ there is no variance. It has been held that directors who are present but decline to vote need not be reckoned in computing whether a

¹ *Bottomley's Case*, 16 Ch. D. 681 (distinguishing *Thames Haven, etc. Co. v. Rose*, 4 Man. & G. 552).

See also *Kirk v. Bell*, 16 Q. B. 290; *Ex parte Ross*, 59 L. T. 291; *Faure Electric Co. v. Phillipart*, 58 L. T. 525; *Toronto Brewing Co. v. Blake*, 2 Ont. 175; *Wright v. First Nat. Bank*, 52 N. J. Eq. 392; 28 Atl. 719; *Sylvania, etc. R. Co. v. Hoge* (Ga.), 59 S. E. 806.

But see *Porter v. Lassen, etc. Co.*, 127 Cal. 261; 59 Pac. 563, declaring that the prescribed quorum of directors may act although the total number may have fallen, by reason of vacancies, below the legal minimum.

² *Scottish Petroleum Co.*, 23 Ch. D. 413; *Owen & Ashworth's Claim* (1901), 1 Ch. 115.

But see *Faure Electric Co. v. Phillipart*, 58 L. T. 525, holding that where by resignations the number of directors is reduced below the prescribed minimum, the continuing members cannot exercise a power vested in "the board" of filling casual vacancies.

³ *Porter v. Lassen, etc. Co.*, 127 Cal. 261; 59 Pac. 563.

⁴ *Wells v. Rahway White Rubber Co.*, 19 N. J. Eq. 402; *Hax v. Davis Mill Co.*, 39 Mo. App. 453; *Edgerly v. Emerson*, 3 Foster (23 N. H.) 555; 55 Am. Dec. 207; *Leavitt v. Oxford, etc. Co.*, 3 Utah 265; 1 Pac. 356; *Buell v. Buckingham, etc. Co.*, 16 Iowa 284; 85 Am. Dec. 516; *Sargent v. Webster*, 13 Mete. (Mass.) 497; 46 Am. Dec. 743; *Lockwood v. Mechanics Bank*, 9 R. I. 308; 11 Am. Rep. 253; *Buck v. Troy Aqueduct Co.*, 56 Atl. 285; 76 Vt. 75; *Cann v. Rector, etc. of Church of Holy Redeemer* (Mo.), 98 S. W. 781, 783 ("A formal resolution was not essential. . . . Oral authority from the majority of the members, given during a session of the body, was sufficient"); *Gumaer v. Cripple Creek, etc. Co.* (Colo.), 90 Pac. 81.

⁵ *Cahill v. Kalamazoo Mut. Ins. Co.*, 2 Doug. (Mich.) 124; 43 Am. Dec. 457.

resolution has been carried. Thus, where the board consists of seven members, all of whom are present but two of whom decline to vote, a majority of the remaining five control the meeting, and may take any action on behalf of the board.¹ So, a blank vote is to be taken as no vote at all, any custom of the corporation to the contrary notwithstanding.² However, where at an election for president, six directors out of the twelve present vote for one candidate, four for another, and two for a third, there is no election.³

§ 1458. **Who may vote.** — *Proxies, interested Directors.* — At a directors' meeting, votes by proxy cannot be received or counted,⁴ and the directors have no power by resolution to alter this rule.⁵ Moreover, directors who are individually interested in any question adversely to the company have no vote thereon.⁶ The whole subject of interested directors is discussed below at considerable length.⁷

§ 1459. *Votes by the President.* — A president or a chairman by announcing that a resolution is carried must be taken to vote therefor if his vote is essential to its passage;⁸ but the president has no casting vote in addition to his vote as director unless there be an explicit provision to that effect,⁹ and where a majority of the meeting is required by statute, a by-law attempting to give the president a second or casting vote in case of a tie is void.¹⁰ On the other hand, the president of the board has or-

¹ *Booker v. Young*, 12 Gratt. (Va.) 303.

But see *Commonwealth v. Wickersham*, 66 Pa. St. 134. Cf. *Oldknow v. Wainwright*, 1 Wm. Bl. 289, s. c. 2 Burr. 1017; *Rollins v. Shaver Wagon, etc. Co.*, 80 Iowa 380, 388; 45 N. W. 1037; 20 Am. St. Rep. 427.

² *Murdoch v. Strange*, 99 Md. 89.

³ *People v. Conklin*, 7 Hun (N. Y.) 188.

⁴ *Portuguese Consolidated Mines*, 42 Ch. D. 160, 165; *Perry v. Tuska-loosa, etc. Co.*, 93 Ala. 364; 9 So. 217; *Craig Medicine Co. v. Merchants Bank*, 59 Hun (N. Y.) 561; 14 N. Y. Supp. 16; *State v. Perkins*, 90 Mo. App. 603.

Cf. *Silsby v. Strong*, 62 Pac. 633,

634; 38 Oreg. 36 (where a proxy was relied upon to show an absentee's knowledge of and consent to the meeting).

⁵ *First Nat. Bank v. East Omaha Box Co.*, 90 N. W. 223, 228-229 (headnote inadequate); 2 Nebr. (unofficial) 820.

⁶ *Smith v. Los Angeles, etc. Ass'n*, 78 Cal. 289; 20 Pac. 677.

Cf. *County Court v. B. & O. R. R. Co.*, 35 Fed. 161.

⁷ *Infra*, § 1529, § 1563 et seq.

⁸ *Fletcher v. Chicago, etc. Ry. Co.*, 67 Minn. 339, 344; 69 N. W. 1085.

⁹ *Toronto Brewing Co. v. Blake*, 2 Ont. 175, 184.

¹⁰ *State v. Curtis*, 9 Nev. 325.

dinarily the same right to vote as any other member, and cannot be confined to a casting vote in case of an equal division.¹

§ 1460. **Statutes or Regulations requiring more than Majority Vote.** — Sometimes, by statute or the company's regulations, upon certain questions of importance more than a mere majority vote is required. Where such is the case, an amendment to the regulations reducing the number required as a quorum does not repeal or in any way affect the by-law which requires a two-thirds vote of the board upon some important resolution, such as a resolution removing an officer.² Where a two-thirds vote of the directors is required, it has been held that there must be two thirds of the entire board and not merely two thirds of the quorum in attendance.³

§ 1461. **Effect of excluding some Directors from Meeting.** — The requirement that notice be given to every director of the time and place of an intended board meeting would be nugatory if some of the members could nullify the notice by excluding their colleagues from the meeting. Accordingly, as is elsewhere explained,⁴ each director has a right, as against his fellows, to insist that he be admitted to their deliberations — a right which he may enforce by legal proceedings. But, further than this, the exclusion of some of the directors would seem to render the meeting, and any action taken there, irregular.⁵

§ 1462. **Place of Meetings.** — Unless the place of directors' meetings be expressly prescribed in the company's regulations,⁶ it rests within their own discretion.⁷ They may certainly meet at any reasonable place within the state under whose laws the corporation is organized, and are not restricted to the company's principal office.⁸ In respect to the ordinary business

¹ *McCullough v. Annapolis, etc. ley Wire Co. v. Illinois Steel Co.*, 164 R. R. Co., 4 Gill (Md.) 58. Ill. 149; 45 N. E. 410; 56 Am. St.

² *Stockton v. Harmon*, 32 Fla. Rep. 187.

³ *Loubat v. LeRoy*, 40 Hun (N. Y.) 546.

⁴ *Infra*, § 1509.

⁵ *Harben v. Phillips*, 23 Ch. D. 14, 26, 27. See also *infra*, § 1463.

⁶ As to express provisions regulating the place of meeting, see *Ash-*

⁷ *Cf. Troy Mining Co. v. White*, 10 S. Dak. 475, 480 (headnote inadequate); 74 N. W. 236; 42 L. R. A. 549.

⁸ *Corbett v. Woodward*, 5 Sawy. 403 (where a by-law authorized the president to convene meetings on giving notice of the time and place).

of the board, where they act as mere agents of the company and superintendents of its business, the courts are substantially agreed that their meetings may be held in foreign territory;¹ and in any such case their action is not rendered void because taken in pursuance of a shareholders' meeting held in the foreign state without legal warrant.² But where they are to act in a so-called corporate capacity — that is, by allotting shares, making calls, etc., — a distinction has been drawn by some authorities, which declare that in such cases the meetings must be held in the corporation's home state.³ This distinction, however, is very shadowy, and, it is submitted, unsound.⁴ On principle, it is submitted that directors' meetings for any purpose may be held at any reasonable place either within or without the company's own state.

¹ *Bellows v. Todd*, 39 Iowa 209 (authorizing deed of company's land); *McCall v. Byram Mfg. Co.*, 6 Conn. 428, 436 (appointment of secretary); *Reichwald v. Commercial Hotel Co.*, 106 Ill. 439 (executing promissory notes and mortgages); *Saltmarsh v. Spaulding*, 147 Mass. 224; 17 N. E. 316 (appointing agents and authorizing mortgage of real estate); *Arms v. Conant*, 36 Vt. 744 (appointing agent to execute deed of mortgage); *Wright v. Lee*, 2 S. Dak. 596; 51 N. W. 706 (authorizing deed of assignment); *Galveston R. R. Co. v. Coudrey*, 11 Wall. 459, 476-477; *Thompson v. Natchez Water Co.*, 68 Miss. 423; 9 So. 821 (issuing mortgage bonds).

Not infrequently, it is expressly provided that directors' meetings shall not be held in a foreign state. *Hilles v. Parish*, 14 N. J. Eq. 380. Cf. *Brockway v. Gadsden Mineral, etc. Co.*, 102 Ala. 620; 15 So. 431. Such a provision renders a meeting held in violation of it not merely voidable by the shareholders but

absolutely void. *State Nat. Bank v. Union Bank*, 168 Ill. 519; 48 N. E. 82.

² *Thompson v. Natchez Water Co.*, 68 Miss. 423; 9 So. 821.

³ *Ormsby v. Vermont Copper Co.*, 56 N. Y. 623 (levying assessment on stock); *Hilles v. Parish*, 14 N. J. Eq. 380 (authorizing transfer of stock) (semble); *Place v. People*, 87 Ill. App. 527 (appointing a president).

Even in such cases some authorities permit the meetings to be held in a foreign state. *Ohio, etc. R. R. Co. v. McPherson*, 35 Mo. 13; 86 Am. Dec. 128 (making calls on unpaid shares). Cf. *McCall v. Byram Mfg. Co.*, 6 Conn. 428; *McConnell v. Combination Mining, etc. Co.*, 30 Mont. 239; 76 Pac. 194; 104 Am. St. Rep. 703; 31 Mont. 563; 79 Pac. 248; *Boatmen's Bank v. Gillespie* (Mo.), 108 S. W. 74.

⁴ See the discussion with regard to the place of shareholders' meetings, *supra*, § 1212.

§ 1463-§ 1466. *Action without regularly convened Board Meeting.*

§ 1463. **By mere Quorum or Majority of the Board.** — As already stated, the principal circumstance distinguishing directors from mere agents is that the former can act only as a board; individually they have no power to bind the corporation. It would, therefore, seem very clear that neither a quorum nor a majority of the directors can act regularly in any other way than through a duly convened meeting. It would follow, therefore, that if a quorum or majority of the directors assent to some resolution, contract, or course of action, severally, without a duly convened meeting, their assent is not that of the board, so that the proceeding is irregular. This is abundantly clear where the prescribed quorum is less than a majority of the board; for “if it were otherwise, a quorum of directors might meet at one place with power to act for the company, and another quorum might, at the same time, meet at a different place and come to an opposite determination.”¹ But even where a majority of the whole board concurs, the importance of a meeting is scarcely less. For the company is entitled to the advice of all of its directors; and, if a meeting were convened, the non-assenting minority might, in consultation, convince and win over their associates. Indeed, if the majority were allowed to act without a meeting, they might practically nullify the rule which prohibits the exclusion of any director from the consultations of the board. Accordingly, the recommendation of six out of seven directors is not equivalent to the recommendation of the board.² So, where the secretary obtains the assent of a quorum (and apparently of a majority) of the directors to the execution of a deed, at private interviews, the affixing of the corporate seal is not legally authorized.³ The only English case tending in the opposite direction is *Collie's Claim*,⁴ where a contract to pay twenty-five per cent commission to a broker for negotiating a successful sale was held binding on

¹ *D'Arcy v. Tamar, etc. Ry. Co.*, L. R. 2 Ex. 158, 162, per Bramwell, B.

² *D'Arcy v. Tamar, etc. Ry. Co.*, L. R. 2 Ex. 158.

³ *D'Arcy v. Tamar, etc. Ry. Co.*, L. R. 2 Ex. 158, 162, per Bramwell, B.

⁴ *Collie's Claim*, 12 Eq. 246, disapproved in *Haycraft Gold Reduction, etc. Co.* (1900), 2 Ch. 230 (headnote inadequate).

the company, although the contract had been signed by a mere quorum of directors and without any meeting having been convened. The case, however, was a very peculiar one, and the decision may be supported on the ground (which also was taken by the court) that the stipulated commission was under the circumstances no more than the broker might have recovered on a *quantum meruit*.

The American cases, also, generally hold that no action of a mere majority of the directors is regular unless it is taken at a duly convened meeting of which all absentees had notice;¹ although some decisions squint the other way.² The necessity for a meeting is not affected by a provision that the majority may exercise the powers of the board.³

¹ *Johnston v. Jones*, 23 N. J. Eq. 216, 227-228; *St. Helen Mill Co.*, 3 Sawy. 88, 92; *Farwell v. Houghton Copper Works*, 8 Fed. 66; *Despatch Line of Packets v. Bellamy Mfg. Co.*, 12 N. H. 205, 224; 37 Am. Dec. 203; *Pauly v. Pauly*, 107 Cal. 8; 40 Pac. 29; 48 Am. St. Rep. 98; *Herrington v. Lisbon*, 47 Iowa, 11; *New Orleans Bldg. Co. v. Lawson*, 11 La. 34; *First Nat. Bank v. Drake*, 35 Kans. 564; 11 Pac. 445; *Peirce v. Morse-Oliver Co.*, 94 Me. 406; 47 Atl. 914; *Hamlin v. Union Brass Co.*, 68 N. H. 292; 44 Atl. 385; *Leonard v. Lent*, 43 Wisc. 83; *People's Bank v. St. Anthony's Church*, 109 N. Y. 512; 17 N. E. 408; *Columbia Bank v. Gospel Tabernacle*, 127 N. Y. 361; 28 N. E. 29; *Constant v. St. Alban's Church*, 4 Daly (N. Y.) 305; *Gordon v. Preston*, 1 Watts (Pa.) 385; 26 Am. Dec. 75; *Taylor v. R. D. Scott Co.* (Mich.), 113 N. W. 32, 33; *Pike Co. v. Rowland*, 94 Pa. St. 238; *First Nat. Bank v. Asheville, etc. Lumber Co.*, 116 N. Car. 827; 21 S. E. 948; *Singer v. Salt Lake, etc. Mfg. Co.*, 17 Utah 143; 53 Pac. 1024; 70 Am. St. Rep. 773; *Vaught v. Ohio, etc. Fair Co.*, 49 S. W. 426; 20 Ky. Law Rep. 1471; *Butler v. Cornwall Iron Co.*, 22 Conn. 335; *Doernbecher v. Columbia City Lumber Co.*, 21 Oreg. 573; 28 Pac. 899; 28 Am. St. Rep.

766; *Hatch v. Lucky Bill Mining Co.*, 25 Utah 405, 415; 71 Pac. 865; *State v. Perkins*, 90 Mo. App. 603; *Farrell v. Gold Flint Mining Co.*, 32 Mont. 416; 80 Pac. 1027; *Mast Buggy Co. v. Litchfield Imp. Co.*, 55 Ill. App. 98; *Kansas City Hay Press Co. v. Devol*, 72 Fed. 717.

Cf. *Lemars Shoe Co. v. Lemars Shoe Mfg. Co.*, 89 Ill. App. 245.

² *State v. Smith*, 48 Vt. 266, 286-287; *Waite v. Windham, etc. Mining Co.*, 37 Vt. 608; *Edgerly v. Emerson*, 3 Foster (23 N. H.) 555; 55 Am. Dec. 207; *Bank of Middleburg v. Rutland, etc. R. R. Co.*, 30 Vt. 159; *Wadham v. Litchfield, etc. Turnpike Co.*, 10 Conn. 416; *Longmont Supply Co. v. Coffman*, 11 Colo. 551; 19 Pac. 508; *American Ex. Bank v. First Nat. Bank*, 82 Fed. 961; 27 C. C. A. 274; *Bank v. Flour Co.*, 41 Oh. St. 552, 558-559 (headnote inadequate); *Cram v. Bangor House Proprietary*, 12 Me. 354; *County Court v. B. & O. R. R. Co.*, 35 Fed. 161, 167 (semble); *Buck v. Troy Aqueduct Co.*, 56 Atl. 285; 76 Vt. 75.

³ *Doernbecher v. Columbia City Lumber Co.*, 21 Oreg. 573, 579; 28 Pac. 899; 28 Am. St. Rep. 766; *Harding v. Vanderwater*, 40 Cal. 77. But see *State ex rel. Page v. Smith*, 48 Vt. 266, 286-287; *Edg-*

§ 1464. *Custom or By-law authorizing action by Quorum without a Board Meeting.* — If the directors adopt the practice of acting whenever a majority are casually assembled, they in effect constitute the majority agents of the company, and therefore in such a case the majority may exercise such powers as might properly be delegated to agents;¹ and indeed we have seen above that a by-law or custom may dispense with the necessity of notice of a meeting,² — that is to say, may authorize a quorum or majority to act as a board whenever they find themselves casually together.

§ 1465. *Unanimous Action of all the Directors without a Meeting.* — If, however, not merely a majority but *all* of the directors assent to some contract or proceeding, it would seem, on principle, to be immaterial that their assents were given separately and not at a board meeting.³ Any other doctrine would lay stress on a mere technicality; for obviously no discussion or interchange of views could take place at a meeting where all are of one mind. According to many weighty American authorities, however, a meeting is necessary even in that case in order that the action may be regular.⁴ But it would probably be

erly v. Emerson, 23 N. H. 555; 55 Am. Dec. 207.

Cf. *Burden v. Burden*, 159 N. Y. 287, 301-302; 54 N. E. 17.

¹ *Estes v. German Nat. Bank*, 62 Ark. 7; 34 S. W. 85.

² *Supra*, § 1450.

³ *Sampson v. Bowdoinham*, 36 Me. 78; *Nat. State Bank v. Sandford Fork, etc. Co.*, 157 Ind. 10, 17; 60 N. E. 699; *Jordan etc., Co. v. Collins & Co.*, 107 Ala. 572; 18 So. 137; *Magowan v. Groneweg*, 91 N. W. 335; 16 S. Dak. 29.

Cf. *Nimmo v. Jackson*, 21 Ill. App. 607, 611; *Davis v. Brown County Coal Co.* (S. Dak.), 110 N. W. 113, 115.

⁴ *Baldwin v. Canfield*, 26 Minn. 43, 54-55; 1 N. W. 261, 276; *Denison v. Austin*, 15 Wisc. 334; *Besch v. Western Carriage Mfg. Co.*, 36 Mo. App. 333; *Audenried v. East Coast Milling Co.* (N. J.), 59 Atl. 577; *Demarest v. Spiral Riveted Tube Co.*,

58 Atl. 161 (headnote inadequate); 71 N. J. Law 14; *Brinkerhoff Zinc Co. v. Boyd*, 192 Mo. 597, 613; 91 S. W. 523.

Cf. *Conro v. Port Henry Iron Co.*, 12 Barb. (N. Y.) 27, 63; *Gashwiler v. Willis*, 33 Cal. 11 (holding that an assent of directors given at a shareholders' meeting is not equivalent to an assent of the board); *Cammeyer v. United German Lutheran Churches*, 2 Sandf. Ch. (N. Y.) 186, 228-230 (same point as last case).

See also *Smith v. Dorn*, 96 Cal. 73; 30 Pac. 1024; *Landers v. Frank Street M. E. Church*, 114 N. Y. 626; 21 N. E. 420; *Monroe Mercantile Co. v. Arnold*, 108 Ga. 449; 34 S. E. 176; *Calumet Paper Co. v. Haskell Show, etc. Co.*, 144 Mo. 331; 45 S. W. 1115; 66 Am. St. Rep. 425; *United Brethren Church v. Vandusen*, 37 Wisc. 54; *Branch v. Augusta Glass Works*, 95 Ga. 573; 23 S. E. 128.

almost universally held that any defect in, or even that a total lack of, notice of a directors' meeting is immaterial if all the members of the board actually meet together,¹ although it would seem that a casual assembling of the directors cannot be treated as a meeting unless all the members of the board consent so to regard the gathering.² Indeed, as stated above, where some of the directors are in some remote foreign state, notice to them is unnecessary; and hence a gathering of the remaining directors is a valid meeting although the notice to these resident members is informal.³ The same law governs where the disinterested members of the board assemble on an informal notice and without notifying a co-director who would have been disqualified by interest from acting.⁴

§ 1466. **Explanation of analogous English Cases as to Action by Subscribers of Memorandum of Association.** — In England, questions similar to those considered in the last two paragraphs have been raised in a line of somewhat analogous cases which require a word of explanation. The articles which are embodied in "Table A," and which are applicable to all corporations organized under the Companies Act of 1862 except those which adopt other articles, provide that the subscribers to the memorandum of association shall appoint the first directors and that until directors are appointed such subscribers shall themselves be "deemed to be directors." Under these provisions, the courts have held that an appointment of directors by the majority of those present at a meeting of the subscribers, of which all have notice, is good if the meeting be attended by a majority of the subscribers,⁵ but

¹ *Rex v. Theodorick*, 8 East 543; *Chase v. Tuttle*, 55 Conn. 455, 467; 12 Atl. 874; 3 Am. St. Rep. 64 (semble); *Stobo v. Davis Provision Co.*, 54 Ill. App. 440.

Cf. *Johnston v. Jones*, 23 N. J. Eq. 216, 228; *Troy Min. Co. v. White*, 10 S. Dak. 475; 74 N. W. 236; 42 L. R. A. 549; *Indiana Bermudez, etc. Co. v. Robinson*, 63 N. E. 797; 29 Ind. App. 59; *Smith v. Paringa Mines* (1906), 2 Ch. 193, 197 (headnote inadequate — where the two directors who composed the board met casually in the passage-way outside the office of one of them).

² Cf. *State ex rel. Grimm v. Manhattan Rubber Mfg. Co.*, 149 Mo. 181; 50 S. W. 321.

³ *Chase v. Tuttle*, 55 Conn. 455, 467; 12 Atl. 874; 3 Am. St. Rep. 64.

But see *Taylor v. R. D. Scott & Co.* (Mich.), 113 N. W. 32, 33 (headnote inadequate).

⁴ *Troy Mining Co. v. White*, 10 S. Dak. 475; 74 N. W. 236; 42 L. R. A. 549.

⁵ *John Morley Bldg. Co. v. Barras* (1891), 2 Ch. 386; *York Tramways Co. v. Willows*, 8 Q. B. D. 685.

not if those in attendance are only a minority.¹ It is further held that a written appointment of directors signed by all the subscribers to the memorandum is effective even though no meeting was held,² but that an appointment made by a mere majority without a meeting of the subscribers is invalid.³ By analogy, these cases support strongly the doctrines advocated in the foregoing paragraphs as to what constitutes a quorum of directors and as to when a board meeting is essential to regularity of action by directors. The analogy is not weakened by the fact that a regulation as to the number of directors necessary to constitute a quorum does not apply to the subscribers to the memorandum acting under Table A;⁴ for the total number of such subscribers may be very different from the total number of directors, and therefore it is not reasonable to suppose that the same number should be the quorum of each body.

§ 1467-§ 1469. *Delegation of Powers by Directors.*

§ 1467. **In general.** — Directors, of course, are not expected to transact personally all the company's business. Their power to appoint agents of all different ranks is, even without express authority, beyond dispute.⁵ So, although the company's regulations make no provision for the office of manager, the directors may nevertheless appoint a general manager of the company's business.⁶ They may authorize one or more of their number to execute deeds, notes, mortgages, etc.⁷

¹ *London, etc. Freehold Land Soc., Barre, etc. Power Co.*, 56 Atl. 530; 31 Ch. D. 223.

Cf. *Howbeach Coal Co. v. Teague*, 5 H. & N. 151.

² *Great Northern Salt Works*, 44 Ch. D. 472.

³ *John Morley Bldg. Co. v. Barras* (1891), 2 Ch. 386, 392 (headnote inadequate).

Cf. *Penobscot R. R. Co. v. White*, 41 Me. 512; 66 Am. Dec. 257.

⁴ *London, etc. Freehold Land Co.*, 31 Ch. D. 223; *Howbeach Coal Co. v. Teague*, 5 H. & N. 151.

⁵ Cf. *infra*, § 1539. But see *Gillis v. Bailey*, 21 N. H. 149, 160-165. Cf. *John A. Roebling's Sons Co. v.*

76 Vt. 131.

⁶ *Gibson v. Barton*, L. R. 10 Q. B. 329.

Cf. *Jones v. Williams*, 139 Mo. 1; 37 L. R. A. 682; 39 S. W. 486; 40 S. W. 353; 61 Am. St. Rep. 436.

⁷ *Burrill v. Nahant Bank*, 2 Metc. (Mass.) 163; 35 Am. Dec. 395; *Leavitt v. Oxford, etc. Ry. Co.*, 3 Utah 265; 1 Pac. 356; *Northampton Bank v. Pepoon*, 11 Mass. 288, 293; *Ridgway v. Farmers Bank*, 12 S. & R. (Pa.) 256; 14 Am. Dec. 681; *Andres v. Fry*, 113 Cal. 124; 45 Pac. 534.

A by-law authorizing the directors to delegate to a committee the duty of levying assessments upon the members has been sustained.¹

But to delegate to others, or to a committee of their own number, their general duty of supervision over the affairs of the corporation is a very different matter; and such delegation unless expressly authorized by statute or the company's regulations is beyond their powers.² Neither can they delegate, except of course where empowered so to do, any power involving discretion, such as the power of allotting shares, that may be expressly confided to them by the incorporation paper,³ or by statute,⁴ or even, it seems, by the company's regulations or by-laws.⁵ The case is still clearer against authority to delegate where the power in question is one which the directors would not possess had it not been expressly conferred upon them;⁶ and hence if the shareholders by mere resolution confide to the directors some power which the latter would not otherwise have possessed, the directors have no right to delegate the power so entrusted to them.⁷ As the directors' own powers are confined to the ordinary business of the company, it follows that necessarily they have no power to delegate to agents the right to act in matters outside the ordinary business of the corporation.⁸

¹ *Fee v. National Masonic, etc. Ass'n*, 110 Iowa 271; 81 N. W. 483.

But see cases cited infra.

² *Tempel v. Dodge*, 89 Tex. 69; 32 S. W. 514; 33 S. W. 222; *Union Nat. Bank v. Hill*, 148 Mo. 380; 49 S. W. 1012; 71 Am. St. Rep. 615.

But see *Hoyt v. Thompson's Ex'r*, 19 N. Y. 207; *Sheridan, etc. Co. v. Chatham Nat. Bank*, 127 N. Y. 517; 28 N. E. 467.

The question was left open in *Gibson v. Barton*, L. R. 10 Q. B. 329, 337.

³ *Howard's Case*, 1 Ch. 561.

⁴ *Weidenfeld v. Sugar Run R. R. Co.*, 48 Fed. 615 (locating road for condemnation); *Farmers, etc. Ins. Co. v. Chase*, 56 N. H. 341 (levying assessment on members of company); *Monmouth, etc. Ins. Co. v. Lowell*, 59 Me. 504 (levying assessment on members of company);

York, etc. R. R. Co. v. Ritchie, 40 Me. 425 (forfeiting shares for unpaid calls); *Pike v. Bangor, etc. R. R. Co.*, 68 Me. 445 (making calls on shareholders); *Pakenham Pork Packing Co.*, 12 Ont. L. R. 100 (allotting shares).

But cf. *Banet v. Alton, etc. R. R. Co.*, 13 Ill. 504, 513-514 (levying calls).

⁵ *Flagstaff Co. v. Patrick*, 2 Utah 304 (removal of inferior agents); *Gillis v. Bailey*, 21 N. H. 149 (leasing real estate); *Garretson v. Equitable Mut., etc. Ass'n*, 93 Iowa 402; 61 N. W. 952 (levying assessments on policy-holders).

⁶ *Cartmell's Case*, 9 Ch. 691.

⁷ *Patterson v. Smelting Works*, 35 Oreg. 96, 105; 56 Pac. 407 (semble).

⁸ *Maryland Trust Co. v. National Mechanics' Bank*, 102 Md. 608, 634-635 (headnote inadequate); 63 Atl. 70.

Of course, the delegation of any powers, even the power of general supervision, may be expressly permitted by statute or by the company's regulations,¹ or possibly by a mere resolution of the shareholders.² Moreover, authority to perform a mere ministerial act may always be delegated.³

A doubt has been expressed whether, when the directors have no power of delegation, they may ratify an act done by a subordinate;⁴ but this doubt appears quite unfounded, for their discretion is exercised in the ratification quite as fully as if they had personally performed the original act.

§ 1468. **Committees.** — Whenever delegation to a committee is authorized, the committee may consist of a single member.⁵ Where the committee consists of two or more, the presence of all (or at any rate notice to all) is necessary to valid action, although probably all need not concur.⁶ An executive committee of directors invested with all the powers of the board during the interval between meetings may, it has been held, delegate to one of its members the power to endorse and collect cheques, this being deemed a merely ministerial act;⁷ but as the committee is invested with delegated powers, the maxim *delegata potestas non potest delegari* ordinarily prevents them from delegating discretionary powers.⁸ An executive committee the

¹ *Peruvian Ry. Co.*, 19 L. T. 803; *Harris's Case*, 7 Ch. 587; *Re Taurine Co.*, 25 Ch. D. 118.

² Cf. *Canada-Atlantic, etc. Co. v. Flanders*, 145 Fed. 875; 76 C. C. A. 1.

³ *Patterson v. Smelting Works*, 35 Oreg. 96; 56 Pac. 407. Cf. *Banet v. Alton, etc. R. R. Co.*, 13 Ill. 504, 513-514 (headnote inadequate).

⁴ *Farmers', etc. Ins. Co. v. Chase*, 56 N. H. 341, 346.

⁵ *MacLagan's Case*, 51 L. J. Ch. 841; *Re Taurine Co.*, 25 Ch. D. 118.

⁶ *Liverpool Household Stores*, 62 L. T. 873, 878.

Cf. *Twelfth Street Market Co. v. Jackson*, 102 Pa. St. 269, 273; *Metropolitan Tel. Co. v. Domestic Tel. Co.*, 44 N. J. Eq. 568, 572-573; 14 Atl. 907; *McNeil v. Boston Chamber of Commerce*, 154 Mass. 277; 28 N. E. 245; 13 L. R. A. 559 (where

the action of a committee at a meeting from which one member was absent was held regular); *Marshall v. Industrial Federation*, 84 N. Y. Supp. 866; 14 N. Y. Ann. Cas. 100; *Wehr v. German Ev. Luth., etc. Congregation*, 47 Md. 177 (holding that building committee of religious corporation may act by a majority); *Third Ave. R. R. Co. v. Ebling*, 12 Daly (N. Y.) 99; *Caldwell v. Mutual Reserve Fund Life Ass'n*, 65 N. Y. Supp. 826, 829.

But see *John A. Roebling's Sons Co. v. Barre, etc. Power Co.*, 56 Atl. 530; 76 Vt. 131; *Canada-Atlantic, etc., Co. v. Flanders*, 145 Fed. 875; 76 C. C. A. 1 (where one member of the committee was absent in Japan).

⁷ *Sheridan, etc. Co. v. Chatham Nat. Bank*, 127 N. Y. 517; 28 N. E. 467.

⁸ *Caldwell v. Mutual Reserve*

appointment of which is expressly authorized may exercise the power of levying assessments on the members of the company.¹

It has recently been held in New York that where an executive committee which by the by-laws is invested with all the powers of the board of directors subject to the orders of the board undertakes to enter into an important contract a few hours before the time named for a meeting of the board, the directors when convened may repudiate the contract without rendering the company liable in damages to the other party thereto.² As the facts disclosed a manifest attempt on the part of the committee to throw off or evade their subordination to the board of directors, the decision would be amply justified if the opposite party to the contract was apprised of the facts at the time of the making of the contract. The report discloses that the directors as soon as they met notified the opposite party that they were considering the contract; but as his rights vested as soon as the contract was executed, it would seem that any such subsequent notice should have been held immaterial.

§ 1469. **Contracts preventing Delegation of Powers by Directors.** — Of course, it is competent for persons who contract with a corporation or who subscribe to its shares to stipulate that action by directors shall be a condition precedent to their liability, and in that case the directors must act personally in order that the liability may attach. Thus, where a contract of subscription to shares contains an express provision that payment shall be made on calls made by two thirds of the directors, the stipulation for a two-thirds instead of a majority vote obviously contemplated a personal exercise of discretion by the directors, and therefore no action by a delegate of the board will bind such a subscriber.³

§ 1470—§ 1483. *EFFECT OF IRREGULARITIES IN EXERCISE OF DIRECTORS' POWERS.*

§ 1470. **Irregular Action not necessarily void.** — The preceding pages embody an attempt to state the norm or standard to which directors' actions should conform; but we should not infer

Fund Life Ass'n, 65 N. Y. Supp. 826.

¹ *Fee v. National Masonic Accident Ass'n*, 110 Iowa 271; 81 N. W. 483.

² *Commercial Wood, etc. Co. v. Northampton Portland Cement Co.* (N. Y.), 82 N. E. 730.

³ *Silver Hook Road v. Greene*, 12 R. I. 164.

that every departure from that standard necessarily and altogether invalidates their action. Such is by no means the case.

§ 1471. **The general Principle — Irregular Action by Directors analogous to Action by ordinary Agents in violation of Principal's Instructions.** — While directors are for some purposes to be treated as if they constituted the corporation itself, yet in almost all cases they are rather to be regarded as agents of the imaginary corporate entity. And, as the law is now well settled that a corporation is governed by the law of agency as fully as is an individual principal, the validity of directors' acts may be tested by the accepted doctrines of agency. The norm to which their actions are to conform, which is prescribed by the company's regulations or charter, or by general law, may be deemed a rule or instruction given by the intangible corporation to its agents, the directors; and any failure on the directors' part to comply therewith may be compared with an agent's disobedience of his principal's commands.

§ 1472-§ 1476. CONSEQUENCES OF THIS PRINCIPLE.

§ 1472. **Ratification of Irregular Action.** — From the proposition stated in the last paragraph, many important consequences flow. In the first place, any irregular or informal action of directors, or action taken by less than a quorum, or by persons purporting to be directors but not rightfully entitled to the office, is to be deemed an act by an agent in excess of, or without, authority; and as such may be ratified by the corporation, that is, by a legal meeting of directors or of the shareholders.¹ Thus,

¹ *Despatch Line of Packets v. Bellamy Mfg. Co.*, 12 N. H. 205 (headnote inadequate); 37 Am. Dec. 203; *Wickersham v. Crittenden*, 110 Cal. 332; 42 Pac. 893; *Gordon v. Preston*, 1 Watts (Pa.) 385; 26 Am. Dec. 75; *County Court v. B. & O. R. R. Co.*, 35 Fed. 161; *Morisette v. Howard*, 62 Kans. 463; 63 Pac. 756; *Moller v. Fibre Co.*, 187 Pa. St. 553; 41 Atl. 478; *Porter v. Lassen, etc. Co.*, 127 Cal. 261; 59 Pac. 563.

are so opposed to the whole spirit of the law in most jurisdictions that they will probably continue to stand by themselves.

There can be no ratification except by authority which would have been sufficient to justify the original action. See *Calumet Paper Co. v. Haskell, etc. Co.*, 144 Mo. 331; 45 S. W. 1115; 66 Am. St. Rep. 425.

As to whether approval of minutes of a previous meeting which was not attended by a quorum amounts to a ratification of the action taken at that meeting, see *Ohio Grand Rapids, etc. Co.*, 13 Ind. 58, *Valley Nat. Bank v. Walton Archi-*

Two cases contra, *State v. Smith*, 15 Oreg. 98, 122; 14 Pac. 814; 15 Pac. 137, 386, and *Price v. Grand Rapids, etc. Co.*, 13 Ind. 58,

an allotment of shares made by directors at a meeting to which some members of the board had not been summoned may be ratified, expressly or impliedly, at any subsequent meeting duly convened, and such ratification is attended with all the consequences which by the law of agency attach to ratification by an individual principal of the unauthorized act of an ordinary agent, and therefore relates back to the time of the original irregular allotment.¹ So, a call made at a board meeting attended by less than the quorum prescribed by the company's regulations may be ratified and validated at a subsequent duly attended meeting.² The ratification may be either express, or implied from acquiescence.³ But in any event the rights of third parties which may have supervened in the meantime will not be affected.⁴ Thus, where an assignment for the benefit of creditors was authorized by a majority of the directors without any duly convened meeting, the deed will become valid from long acquiescence of the shareholders, but no such acquiescence can defeat the lien of an attachment levied before the ratification could be deemed to have taken place.⁵

§ 1473-§ 1476. *Non-Compliance by Directors with Regulations as to "Indoor Management" of Company does not invalidate their Action as regards a Third Person without Notice of the Irregularity.*

§ 1473. *In general.* — *Reasons for the Doctrine.* — By the law of agency, an agent's disregard of his principal's instructions will not always prevent his actions from binding the principal. For if the agent is clothed with general authority over a subject-matter, restrictions on his powers, or instructions as to the manner in which he shall exercise them, do not, unless com-

tectural Iron Co., 30 Wkly. Law Bull. (Oh.) 382 and supra, § 1243, and infra, § 1545. see further *Ashley Wire Co. v. Illinois Steel Co.*, 164 Ill. 149; 45 N. E. 410; 56 Am. St. Rep. 187.

¹ *Portuguese Consolidated Copper Mines*, 45 Ch. D. 16.

² *Austin's Case*, 24 L. T. 932.

³ *Gordon v. Preston*, 1 Watts (Pa.) 385; 26 Am. Dec. 75; *Moller v. Fibre Co.*, 187 Pa. St. 553; 41 Atl. 478.

As to acquiescence of directors, in general, see infra, § 1486, § 1487.

⁴ Cf. *Audenried v. East Coast Milling Co.* (N. J.), 59 Atl. 577.

⁵ *Vaught v. Ohio, etc. Fair Co.*, 49 S. W. 426; 20 Ky. Law Rep. 1471.

As to ratification by acquiescence,

municated to third persons who may deal with him, prevent him from binding the principal, even though he disobey his orders; and, even if a third party is chargeable with knowledge of limitations on the agent's authority, still if he have reason to believe that they have been complied with, he is not disabled from holding the principal, although the agent may not in fact have duly observed his instructions. These doctrines are applicable to directors. For directors are agents clothed with the widest authority, and the rules prescribed by law and the constitutions of their companies for the manner of exercise of their powers may be regarded as so many restrictive instructions given by the imaginary corporate principal to the directors as its agents. To be sure, whenever these restrictions are found in general laws, or in the company's special act of incorporation or charter, or in its incorporation paper, all persons dealing with the company are charged with constructive notice thereof. And in England the same rule is applicable to a company's articles of association, which are in effect, as elsewhere stated, recorded by-laws. In America, however, where the mere by-laws of a corporation are not recorded, strangers dealing with the company are not affected with constructive notice of their contents, and hence unless actual knowledge of the by-laws is brought home to them, they may hold the corporation for the acts of its directors in violation of the by-laws.¹ But even where the restrictions are embodied in the company's recorded constitution, or in its charter, or in public statutes, they are regarded as regulations of matters of internal corporate management compliance with which any stranger dealing with the company is entitled to assume, in the absence of actual notice to the contrary.

§ 1474. **Leading Case** — *Royal British Bank v. Turquand*.— This proposition, which is thus seen to be a deduction from established doctrines of agency, constitutes what is known as the rule in the *Royal British Bank v. Turquand*.² Although that case was not the first in which the principles were applied to corporations, yet it was a strong decision on the point, in the morning of the law of modern incorporated companies. The deed of settlement of a company incorporated under the Companies Act of 1844 provided that the directors might borrow on bond such

¹ See *supra*, § 732.

² *Royal British Bank v. Turquand*,
6 E. & B. 327.

sum as a general resolution of the shareholders might authorize. The Court of Exchequer Chamber held that persons dealing with such companies are bound to read the statute and the deed of settlement. "But," said Jervis, C. J., "they are not bound to do more. And the party, here, on reading the deed of settlement, would find not a prohibition from borrowing, but a permission to do so on certain conditions. Finding that the authority might be made complete by resolution, he would have a right to infer the fact of a resolution authorizing that which on the face of the document appeared to be legitimately done." Accordingly, it was held that a bond issued by the directors to secure a loan to the company might be enforced by an innocent obligee although no resolution of a general meeting had in fact been passed. Any restriction imposed by statute or the company's incorporation paper which involves merely a matter of internal regulation and which therefore lies exclusively within the knowledge of the corporation and its agents may, so far as a stranger is concerned, be assumed to have been complied with; and if in fact the internal regulation has not been complied with, the innocent third party is not to be prejudiced.

§ 1475. **Miscellaneous Applications of the Principle.** — This doctrine has been applied in many cases.¹ Thus, although an incorporation paper or a statute require the sanction of the shareholders to the issue of bonds or debentures, yet debentures issued without such authority are enforceable in the hands of a holder who had no notice of the irregularity.² So also, where a

¹ In addition to cases cited below, see *Mining Co. v. Anglo-Californian Bank*, 104 U. S. 192; *Hackensack Water Co. v. DeKay*, 36 N. J. Eq. 548.

The application of the doctrine to municipal bonds issued without compliance with some statutory condition but containing a recital of due performance has occasioned much litigation and diversity of opinion. See 1 Dillon on Municipal Corporations, 4th ed., § 521 et seq. One difficulty lies in determining how far holders of municipal securities are charged with notice of the records of the corporation, which of course are public records. Upon

this ground, Justice Miller in *Humboldt Township v. Long*, 92 U. S. 642, 650, in a dissenting opinion, vigorously denied that the doctrine should be applied to municipal corporations. In distinguishing *Royal British Bank v. Turquand*, that learned judge fell into the error of stating that the Bank was not a corporation, whereas in fact the Bank was incorporated under the Companies Act of 1844. The majority of the court preferred to follow *Knox County v. Aspinwall*, 21 How. 539, which had extended the doctrine of *Royal British Bank v. Turquand* to municipal corporations.

² *Agar v. Atheneum Life Soc.*, 3

statute enacted that railway companies might aid other railroads by subscribing to their stock or otherwise, and provided that the act might be accepted by existing companies by filing with the Secretary of State a copy of a resolution to that effect, the United States Supreme Court held that a railway company's guaranty of another company's bonds was valid, although no such acceptance had been filed, as against *bona fide* holders ignorant of the irregularity.¹ So, where a company's deed of settlement provided that the corporate seal should not be affixed to any policy of insurance except upon the order of three directors, by whom it should be signed, with the counter-signature of the secretary, and a policy was issued signed by three directors countersigned by the secretary, the company was held to be bound although no previous order for the affixing of the seal had been given by the three directors.² This case illustrates neatly the limits of the constructive knowledge of the company's incorporation paper.³ The policy-holder was to be

C. B., N. S., 725; *Fountain v. Car-mathen Ry. Co.*, 5 Eq. 316. See also to substantially the same effect: *Landowners Co. v. Ashford*, 16 Ch. D. 411, 438 (a good case); *Hampshire Land Co.* (1896), 2 Ch. 743; *Zabriskie v. Cleveland, etc. R. R. Co.*, 23 How. 381, 400; *Louisville, etc. Ry. Co. v. Louisville Trust Co.*, 174 U. S. 552; 19 Sup. Ct. 817 (a strong case); *Galbraith v. Shasta Iron Co.*, 143 Cal. 94; 76 Pac. 901; *Marvin v. Anderson*, 111 Wisc. 387; 87 N. W. 226 (semble); *Manhattan Hardware Co. v. Phalen*, 128 Pa. St. 110; 18 Atl. 428; *Manhattan Hardware Co. v. Roland*, 128 Pa. St. 119; 18 Atl. 429.

But see *Commercial Bank of Canada v. Great Western Ry. Co.*, 13 L. T. 105; *Louisville, etc. R. R. Co. v. Ohio Valley Imp. Co.*, 69 Fed. 431; *Georgetown Water Co. v. Central Thomson-Houston Co.* (Ky.), 34 S. W. 435, slightly modified in 35 S. W. 636; 17 Ky. Law Rep. 1270; *Eastman v. Parkinson* (Wisc.), 113 N. W. 649; *Williams v. Gaylord*, 186 U. S. 157 (headnote inadequate); 22 Sup. Ct. 798 (following Cali-

fornia decisions on a question of local law).

The rule stated in the text is sometimes put upon the ground that only shareholders can complain of non-compliance with such a requirement. *New York Economical Printing Co.*, 110 Fed. 514; 49 C. C. A. 133 (statute requiring the filing of consent of shareholders to execution of a mortgage); *Bishop v. Kent & Stanley Co.*, 41 Atl. 255; 20 R. I. 680 (arising under a statute very similar to that involved in the last case); *Central Trust Co. v. Condon*, 67 Fed. 84; 14 C. C. A. 314 (under a similar statute). But it is submitted that in most cases not even shareholders could avoid the transaction.

¹ *Zabriskie v. Cleveland, etc. R. R. Co.*, 23 How. 381, 397-399.

² *Prince of Wales Co. v. Harding*, E. B. & E. 183.

³ See also *Heiton v. Waverley Hydropathic Co.*, 4 Rettie (Sc.) 830, 834, where the Lord President referring to a notice of a general meeting, said, "That is no doubt in violation of one of the regulations of

treated as knowing that the order and signatures of three directors were necessary; and if the policy had been signed by less than three he could not have recovered¹ (unless the regulation were regarded as purely directory),² since the policy itself would have notified him of its non-conformity with the requirement; but the absence of the previous order was a defect of "indoor management" which nothing could lead him to suspect and by which therefore he could not be prejudiced. Upon the same principle, where the company's regulations provide that the directors shall have power to fix a quorum, a company is bound by a mortgage which is authorized by the directors at a meeting attended by less than the quorum which the board had previously determined upon, if the mortgagee had no knowledge of the irregularity.³ So, a mortgage or other deed authorized by a majority of directors at a meeting at which due notice had not been given is valid in the hands of the innocent mortgagee or grantee.⁴ It seems that the same doctrine would be applied where the number of the directors, when the transaction was authorized, had fallen below the minimum prescribed in the

the company, and one of the regulations which forms an article of association, and which is published to the world. But although third parties know that an extraordinary general meeting of the company must be summoned in that particular way, the question remains whether they are bound to inquire and satisfy themselves whether a particular general meeting for the purpose of passing the resolution under which the directors are acting was so summoned. I hold it to be perfectly clear law that they are not bound so to inquire, but, on the contrary, that they are entitled to assume that everything has been regularly done in the summoning of the meeting of the company at which such resolution is passed."

¹ *Ridley v. Plymouth, etc. Baking Co.*, 2 Ex. 711.

² As to which see *supra*, § 476, § 491, § 1060, § 1070.

³ *County of Gloucester Bank v. Rudry Methyr Colliery Co.* (1895), 1 Ch. 629; *Montreal, etc. Power Co. v. Robert* (1906), A. C. 196, 202-203 (purchase of land for company).

Cf. *Halifax Sugar Refining Co. v. Franchlyn*, 59 L. J. Ch. 591.

⁴ *Ashley Wire Co. v. Illinois Steel Co.*, 164 Ill. 149; 45 N. E. 410; 56 Am. St. Rep. 187; *Kuser v. Wright*, 52 N. J. Eq. 825; 31 Atl. 397; *Morisette v. Howard*, 62 Kans. 463; 63 Pac. 756.

Cf. *Barrell v. Lake View Land Co.*, 122 Cal. 129; 54 Pac. 594; *Miller v. Chance*, 3 Edw. Ch. (N. Y.) 399; *Samuel v. Holladay*, 1 Woolwich 400; *Scott v. Superior Sunset Oil Co.*, 144 Cal. 140, 143; 77 Pac. 817; *First Nat. Bank v. East Omaha Box Co.*, 90 N. W. 223; 2 Nebr. (unofficial) 820; *Wyss-Thalman v. Beaver Valley Brewing Co.* (Pa.), 68 Atl. 187 (contract binding although directors' meeting at which it was authorized was called without due notice to one director).

regulations;¹ or where more than the lawful number of directors have been elected and are acting.² Where, however, a contract is made by a board meeting of which one of the directors was not notified, with a person who was present at the meeting and knew that a director was absent, the contractor has been held to be put upon inquiry to ascertain whether notice was given, so as not to be within the protection of the principle now under consideration³ — a rather harsh decision.

§ 1476. **Who are within the Protection of the Principle — Shareholders, Officers, the Directors, the Company itself.** — The rule in *Royal British Bank v. Turquand* is generally stated as if it protected only strangers or non-members of the company; but such is not the fact.⁴ Thus, one who has acted as secretary for the corporation may recover remuneration from the company although no resolution fixing the amount of such compensation had been passed by a general meeting as required by statute.⁵ So, where a company's deed of settlement required the approval of the board of directors attested by certificate signed by three directors as a condition to the validity of an assignment of shares, a transferor was held to be relieved from further liability as a shareholder by a transfer which had never been approved by the board but in respect to which a certificate of approval had been signed by three directors and which had been registered on the company's books.⁶ The omission of the formal approval by the board was a mere matter of "indoor management"; and the rule in *Royal British Bank v. Turquand* was held to apply and to protect the innocent shareholder. But the rule has been held to afford no protection to a director, on the ground that the duties of his position require him to have knowledge of the company's "indoor management," so that he should not be allowed to take advantage of his ignorance.⁷ As a matter of public policy,

¹ *Owen and Ashworth's Claim* (1901), 1 Ch. 115.

Cf. *Davies v. R. Bolton, etc. Co.* (1894), 3 Ch. 678; *Wright v. First Nat. Bank*, 52 N. J. Eq. 392; 28 Atl. 719.

² *Hax v. Davis Mill Co.*, 39 Mo. App. 453.

³ *Farwell v. Houghton Copper Works*, 8 Fed. 66.

⁴ *Jackson v. Cannon*, 10 Brit. Columb. 73 (a case of a shareholder dealing with the company).

⁵ *Bill v. Darenth Valley Ry. Co.*, 1 H. & N. 305.

⁶ *Bargate v. Shortridge*, 5 H. L. Cas. 297.

⁷ *Ex parte Brown*, 19 Beav. 97.

See also *Ex parte Henderson*, 19 Beav. 107.

But cf. *Bush's Case*, 6 Ch. 246.

this decision may well enough be sound. Certainly it would seem clear on principle that the rule in *Royal British Bank v. Turquand* cannot be invoked in favor of the company itself.¹

§ 1477-§ 1483. *De Facto Directors.*

§ 1477. **General Statement of the Doctrine.** — The well-known doctrine of *de facto* directors is an application, or at most a logical extension, of the principle of *Royal British Bank v. Turquand*. Those dealing with persons who are permitted by a corporation to act as its directors and who have color of right to the office are entitled to assume that all requirements of law and of the company's regulations in respect to their election have been complied with;² and public policy requires that the acts of such acting directors shall not be overturned because some defect in their appointment shall afterwards transpire.³ This is the rule of the common law, and applies not only to directors but to other corporate officers.⁴ Thus, where a person who was named in the company's articles as its first director appointed, unwarrantably, a board of directors who proceeded to carry on the company's business, those thus illegally appointed were *de facto*

¹ Cf. *infra*, § 1478.

² *Mahony v. East Holyford, etc. Mining Co.*, L. R. 7 H. L. 869.

³ The principle has been applied in the following cases, among others, in addition to those more particularly referred to below. *Mining Co. v. Anglo-Californian Bank*, 104 U. S. 192; *The Vigilancia*, 73 Fed. 452; 19 C. C. A. 528; *Sampson v. Bowdoinham, etc. Corp.*, 36 Me. 78; *Penobscott, etc. R. R. Co. v. Dunn*, 39 Me. 587; *Burr v. M'Donald*, 3 Gratt. (Va.) 215; *Baird v. Bank of Wash.*, 11 S. & R. (Pa.) 411; *Zearfoss v. Farmers, etc. Inst.*, 154 Pa. St. 449; 26 Atl. 211; 35 Am. St. Rep. 848; *Bradford v. Frankfort, etc. R. R. Co.*, 142 Ind. 383; 40 N. E. 741; 41 N. E. 819; *Ellis v. North Car. Inst.*, 68 N. Car. 423; *Hall v. Publishing Co.*, 180 Pa. St. 561; 37 Atl. 106 (confession of judgment against corporation by *de facto* directors); *Heinze v. South Green*

Bay, etc. Co., 109 Wisc. 99; 85 N. W. 145; *Ohio, etc. R. R. Co. v. McPherson*, 35 Mo. 13; 86 Am. Dec. 128 (directors elected in foreign state); *Wright v. Lee*, 2 S. Dak. 596; 51 N. W. 706 (directors elected in foreign state); *Balfour-Guthrie Co. v. Woodworth*, 124 Cal. 169; 56 Pac. 891; *Barrell v. Lake View Land Co.*, 122 Cal. 129; 54 Pac. 594; *Duck v. Tower Galvinizing Co.* (1901), 2 K. B. 314; *Gleason v. Canterbury Mut. Fire Ins. Co.* (N. H.), 64 Atl. 187; 73 N. H. 583.

⁴ The doctrine of *de facto* directors and officers in the case of business corporations differs widely in respect to its underlying principle and its extent of application from the doctrine of *de facto* public officers and municipal officials, with which it should not be confused. See 2 Morawetz on Priv. Corps., 2d ed., § 640.

directors, and contracts made by them with innocent third parties bound the company to the same extent as if their tenure of office had been *de jure*.¹ The same principle applies where the mode of appointment is regular enough, but where the appointee is not qualified.² So also, a person chosen as director in excess of the legal number of directors may be a *de facto* director.³ But a person attempting to act without color of right does not become a director even *de facto*, certainly not if there is a *de jure* board in existence which disputes his right,⁴ or if his right to the office is challenged on the very first occasion on which he attempts to exercise its functions.⁵ And, generally, one cannot be a director *de facto* unless he is in actual and notorious possession of the office exercising without let or hinderance its usual functions.⁶ A judgment ousting *de facto* directors from the office, deprives them for the future of the power to bind the company by contract; but the judgment will not produce that effect until it is not merely signed by the judges but also filed with the clerk.⁷ Where shareholders delegate to persons who are acting as directors the power to execute a deed, it is hardly necessary to resort to

¹ *County Life Ass. Co.*, 5 Ch. 288.

² *Hamilton Trust Co. v. Clemes*, 17 N. Y. App. Div. 152, 157; 45 N. Y. Supp. 141 (affirmed 163 N. Y. 423, 424-425; 57 N. E. 614); *Delaware, etc. Canal Co. v. Pa. Coal Co.*, 21 Pa. St. 131, 146; *Despatch Line of Packets v. Bellamy Mfg. Co.*, 12 N. H. 205; 37 Am. Dec. 203; *San Jose Savings Bank v. Sierra Lumber Co.*, 63 Cal. 179; *Kuser v. Wright*, 52 N. J. Eq. 825; 31 Atl. 397; *Atlas Nat. Bank v. Gardner Co.*, 8 Biss. 537; *Hastings v. Blue Hill, etc. Corp.*, 9 Pick. (Mass.) 80; *Hackensack Water Co. v. DeKay*, 36 N. J. Eq. 548, 558; *Modstock Mining Co. v. Harris*, 40 Nova Scotia 336.

But see *Re Newcomb*, 18 N. Y. Supp. 16; 42 N. Y. St. Rep. 442; *Cupit v. Park City Bank*, 20 Utah 292; 58 Pac. 839 (holding that after vacation of office in pursuance of statute by becoming indebted to the company, the former incumbent although continuing to act is not even a *de facto* director).

³ *Werle v. Northwestern Flint, etc. Co.*, 104 N. W. 743; 125 Wisc. 534. Cf. *supra*, § 1430.

⁴ *Johnston v. Jones*, 23 N. J. Eq. 216, 228-229; *Ellsworth, etc. Mfg. Co. v. Faunce*, 79 Me. 440; 10 Atl. 250; *Lebanon, etc. Co. v. Adair*, 85 Ind. 244. Cf. *Franco-Texan Land Co. v. Laigle*, 59 Tex. 339.

But see *Easterly v. Barber*, 65 N. Y. 252.

⁵ *Franco-Texan Land Co. v. Laigle*, 59 Tex. 339; *State v. Curtis*, 9 Nev. 325.

⁶ *Waterman v. Chicago, etc. R. R. Co.*, 139 Ill. 658; 29 N. E. 689; 32 Am. St. Rep. 228; 15 L. R. A. 418; *State v. Curtis*, 9 Nev. 325.

See also *Rozecrans Gold Mining Co. v. Morey*, 111 Cal. 114; 43 Pac. 585.

Cf. *Ellsworth Mfg. Co. v. Faunce*, 79 Me. 440; 10 Atl. 250.

⁷ *Mining Co. v. Anglo-Californian Bank*, 104 U. S. 192.

the doctrine of *de facto* officers in order to uphold the validity of the authority; even if they were not *de facto* directors they could lawfully execute the deed as special agents of the company for that purpose.¹

§ 1478. **In whose Favor the Doctrine applies** — *Shareholders, the Company, the supposed Directors, etc.* — The doctrine is usually invoked in favor of non-members of the corporation who have dealt with the *de facto* directors; but it has been shown above that the principle of *Royal British Bank v. Turquand* protects members of the company as well as strangers,² and hence there would seem to be no reason why the cognate principle of *de facto* directors should not apply against the company even in favor of its own shareholders.³ So, a person appointed secretary of the corporation by a *de facto* board of directors becomes a *de jure* officer.⁴ Moreover, a necessary result of holding that a contract entered into by *de facto* directors is binding against the company is that, being a good contract, there must be mutuality of obligation, so that it may also be enforced by the corporation.⁵

But the company itself, in matters of internal management will not be allowed to rely on the acts of *de facto* directors as against the opposition of shareholders, who have agreed to be bound by regular action of duly elected corporate officers but not by the action of mere *de facto* usurpers. Thus, the English cases clearly hold that a call made by *de facto* directors is not enforceable against the shareholders, and *a fortiori*,⁶ that a declaration by them of a forfeiture of shares is invalid.⁷ Some American cases,

¹ *Milliken v. Steiner*, 56 Ga. 251, 5 H. & N. 151; *Garden Gully Mining Co. v. McLister*, 1 A. C. 39.

² *Supra*, § 1476.

³ *Hastings v. Blue Hill Corp.*, 9 Pick. (Mass.) 80.

⁴ *State v. Kupferle*, 44 Mo. 154; 100 Am. Dec. 265; *Collier v. Consolidated Ry., etc. Co.*, 57 Atl. 417; 70 N. J. Law 313 (sales agent appointed by *de facto* directors awarded damages for dismissal).

⁵ *Vernon Society v. Hills*, 6 Cow. (N. Y.) 23; 16 Am. Dec. 429; *Dela-ware, etc. Canal Co. v. Pa. Coal Co.*, 21 Pa. St. 131.

Cf. *Baggot v. Turner*, 21 Wash. 339; 58 Pac. 212.

⁶ *Howbeach Coal Co. v. Teague*,

accord: *People's Mut. Ins. Co. v. Westcott*, 14 Gray (Mass.) 440, 442; *Christopher v. Noxon*, 4 Ont. 672; *Moses v. Thompkins*, 84 Ala. 613; 4 So. 763; *Schwab v. Frisco Mining Co.*, 21 Utah 258; 60 Pac. 940; *Macon, etc. R. R. Co. v. Vason*, 57 Ga. 314, 317-318.

⁷ *Garden Gully Mining Co. v. McLister*, 1 A. C. 39.

accord: *Schwab v. Frisco Mining Co.*, 21 Utah 258; 60 Pac. 940, with which compare *Jackson v. Crown Point Mining Co.*, 21 Utah 1; 81 Am. St. Rep. 651; 59 Pac. 238; *Howbeach Coal Co. v. Teague*, (stated *infra*, § 1485); and *Jones v.*

however, are apparently in conflict with these decisions.¹ A person who has knowledge of a defect in the appointment of directors or other corporate officers and is also aware that their right to the office has been denied by a court of law cannot enforce against the corporation a contract entered into by them on its behalf.² *A fortiori*, the person himself whose title is defective cannot invoke in his own favor the doctrine of *de facto* directors; and therefore a corporate officer suing for his salary must show a *de jure* occupation of the office.³

§ 1479. **Position of De Facto Directors as Directors De Son Tort.** — The position of directors with respect to their own rights and liabilities is that of, so to speak, directors *de son tort*. Just as executors *de son tort* are liable to all the burdens and incapacities incident to an executorship, so directors *de facto* are liable to all the burdens incumbent on a lawful officer. Thus, a *de facto* director might be proceeded against under § 165⁴ of the English Companies Act of 1862 which provided a summary remedy against directors for misfeasance.⁵ And, generally, a *de facto* occupant of any office under a private corporation is liable to any penalties imposed on the holder of that office either by statute or by common law.⁶ So, he is subject to

Bonanza Mining Co. (Utah), 91 Pac. 273.

¹ *Langan v. Francklyn*, 29 Abb. N. C. 102; 20 N. Y. Supp. 404; *Schenectady, etc. Co. v. Thatcher*, 11 N. Y. 102; *Ohio, etc. R. R. Co. v. McPherson*, 35 Mo. 13; 86 Am. Dec. 128; *San Joaquin Land Co. v. Beecher*, 101 Cal. 70, 80; 35 Pac. 349; *Covington, etc. Plank-Road Co. v. Moore*, 3 Ind. 510; *Steinmetz v. Versailles, etc. Turnpike Co.*, 57 Ind. 457; *Jones v. Bonanza Mining, etc. Co.* (Utah), 91 Pac. 273.

In *Macon, etc. R. R. Co. v. Vason*, 57 Ga. 314, 317-318, the same result was reached but upon the ground that the particular shareholder in question had acquiesced in the illegal constitution of the board.

Cf. *Modstock Mining Co. v. Harris*, 40 Nova Scotia 336 (stated *infra*, § 1479).

² *St. Luke's Church v. Matthews*,

4 Desaus. (S. Car.) 578; 6 Am. Dec. 619; *State v. Curtis*, 9 Nev. 325.

Cf. *Staffordshire Gas & Coke Co.*, 66 L. T. 413.

But see *Atlas Nat. Bank v. Gardner*, 8 Biss. 537, 541-543.

³ See *infra*, § 1479.

⁴ As to which see *infra*, § 1513.

⁵ *Coventry and Dixon's Case*, 14 Ch. D. 660, 664, 665, 670, 673.

⁶ *Gibson v. Barton*, L. R. 10 Q. B. 329; *Newcomb v. Reed*, 12 Allen (Mass.) 362; *Halstead v. Dodge*, 1 How. Pr., n. s. (N. Y.), 170.

Cf. *Easterly v. Barber*, 65 N. Y. 252; *Donnelly v. Pancoast*, 15 N. Y. App. Div. 323; 44 N. Y. Supp. 104; *Hudson v. Parker Co.*, 173 Mass. 242; 53 N. E. 867; *Union Nat. Bank v. Scott*, 53 N. Y. App. Div. 65; 66 N. Y. Supp. 145; *Mutual Life Ins. Co. v. McCurdy*, 103 N. Y. Supp. 829; *Welker v. Anheuser-*

the same incapacity of contracting with the company as a *de jure* director.¹

On the other hand, it is doubtful whether merely by acting as director without title to the office an actionable wrong is committed against the company. Thus, where the lawful directors hold no meetings and generally abdicate their functions, the president and the secretary are not liable for stepping in and, honestly, to the best of their ability, performing the duties of the directors.²

If directors *de facto* are to be regarded as directors *de son tort*, they are not entitled to any of the rights and privileges of the office, and therefore cannot claim any compensation for their services; and such is probably the law.³ It is true, one who has acted as secretary of a corporation without technically regular appointment has been allowed to recover remuneration;⁴ but the cases are hardly parallel, since a subordinate officer, such as a secretary, is to be treated as a stranger contracting with the company. Indeed, the lawful officers of a private corporation who have been unduly ousted by intruders, have been allowed to recover from the intruders any salary attaching to the office, which the latter may have collected.⁵ It has, however, been held in Nova Scotia that a secretary of the company upon his removal from office cannot refuse to surrender the books of the company to *de facto* but disqualified directors.⁶

§ 1480. **Further Miscellaneous Cases in which De Facto Directors are treated as if they were lawful Directors.**—Instances might be multiplied in which the fact that a person is a *de facto* director has the same effect as if he were a *de jure* director. Thus, service of process on a *de facto* officer binds the company to the

Busch Brewing Ass'n (Minn.), 114 N. W. 745. 7 S. & R. (Pa.) 386; *Shellenberger v. Patterson*, 168 Pa. St. 30; 31 Atl. 943; *Waterman v. Chicago, etc. R. R. Co.*, 139 Ill. 658; 29 N. E. 689; 32 Am. St. Rep. 228; 15 L. R. A. 418; *Lebanon, etc. Co. v. Adair*, 85 Ind. 244 (headnote inadequate).

¹ *Charter Gas Engine Co. v. Charter*, 47 Ill. App. 36; *Stetson v. Northern Investment Co.*, 104 Iowa 393; 73 N. W. 869.

² *North Hudson Bldg., etc. Ass'n v. Childs*, 82 Wisc. 460; 52 N. W. 600; 33 Am. St. Rep. 57.

³ *Salton v. New Beeston, etc. Co.* (1899), 1 Ch. 775, 779; *Woolf v. East Nigel Gold Mining Co.*, 21 Times L. R. 660.

⁴ *Bill v. Darent Valley Ry. Co.*, 1 H. & N. 305. Cf. *Waite v. Windham, etc. Co.*, 37 Vt. 608.

⁵ *State ex rel. Howerton v. Tate*, 70 N. Car. 161.

⁶ *Modstock Mining Co. v. Harris*,

Cf. *Riddle v. County of Bedford*, 40 Nova Scotia 336.

same extent as if he had been *de jure* in office.¹ If *de facto* directors perform the statutory duty of directors in respect to making annual reports and the like, the statute is complied with, and neither they nor the *de jure* directors are liable to the penalties denounced against its breach.² A *de facto* director has the same power as a *de jure* director to convene a legal shareholders' meeting.³

§ 1481. **Effect of Existence of De Facto Directors on Powers of De Jure Directors.** — It would seem very clear on principle that the existence of a board of *de facto* directors cannot prevent *de jure* directors from acting, and binding the corporation, but the contrary view is supported by at least apparent judicial authority.⁴ Indeed, it may be doubted how far the doctrine of *de facto* directors applies when there is in existence a board of *de jure* directors.⁵

§ 1482. **Regulations expressly validating Acts of De Facto Directors.** — Provisions are sometimes found in acts of incorporation and in companies' regulations which purport expressly to validate the acts of *de facto* directors. In England, a very common provision is that "all acts done by any meeting of directors, or of a committee of directors, or by any person acting as a director, shall, notwithstanding that it be afterwards discovered that there was some defect in the appointment of any such directors or persons acting as aforesaid, or that they or any of them were disqualified, be as valid as if every such person had been duly appointed and was qualified to be a director."⁶ That such provisions go further than the common-law rule can hardly be doubted; but, in the existing state of the authorities, difficulty would be experienced in particularizing the respects in which they do so. Decisions construing and applying such provisions are important not merely for their bearing on similar provisions, which are likely to crop up at any time, but also for the light they throw on the common-law rule: for, wherever such provisions are held not to validate the acts of *de facto* directors, it is safe to say that the common law would not do so.

¹ *McCall v. Byram Mfg. Co.*, 6 Conn. 428.

⁴ *Hudson River, etc. R. R. Co. v. Hay*, 14 Abb. Pr., N. S. (N. Y.), 191.

² *Wallace v. Walsh*, 125 N. Y. 26; 25 N. E. 1076; 11 L. R. A. 166.

⁵ Cf. *supra*, § 1477.

³ See *supra*, § 1195.

⁶ Companies Act, 1862, Table A,

§ 71.

Some authorities, laying stress on the words "afterwards discovered" in the above quoted provision, have reasoned that it could not apply where the defect in the appointment was all along known to the acting directors;¹ but this has been with good reason questioned.² However, it would seem that the acts of a mere usurper having no color of right to the office would not be validated;³ and Lord Hatherley expressed the opinion that *bona fides* on the part of the acting director would be necessary to bring the case within the scope of such a provision.⁴ At all events, one who deals with *de facto* directors cannot avail himself of such a provision if he was aware of the defect in their appointment or qualification.⁵ Neither are the acts of less than a quorum of *de jure* directors validated thereby,⁶ although it should never be forgotten that in favor of innocent third parties such acts might be valid under the rule in *Royal British Bank v. Turquand*.⁷ The "disqualification" referred to in the provision above quoted does not refer only to disqualification by reason of failure to hold the requisite shares, but applies as well to any other circumstances that under the company's regulations incapacitates one from acting as director, such as the holding of another office in the same corporation.⁸ It is now settled that these validating provisions apply not merely in favor of strangers but also in favor of the corporation as between it and its members, so as to validate calls and forfeitures of shares made by *de facto* directors.⁹ And, generally, under these provisions, *de*

¹ *Murray v. Bush*, L. R. 6 H. L. 37, 53 (per Lord Chelmsford).

See also *British Asbestos Co. v. Boyd* (1903), 2 Ch. 439, 444.

² *Murray v. Bush*, L. R. 6 H. L. 37, 70 (per Lord Cairns); *York Tramways Co. v. Willows*, 8 Q. B. D. 685, 696, 699; *Dawson v. African Co.* (1898), 1 Ch. 6; *Ex parte Bentinck*, 1 Megone 12, 21 (headnote inadequate); *British Asbestos Co. v. Boyd* (1903), 2 Ch. 439 ("The words . . . do not mean . . . that the facts are afterwards discovered but that the defect is afterwards discovered. . . . It is not that the facts are not known but that the knowledge of the defect is not present to the mind of any person to

whom it is material at the time to know it").

³ *Tyne, etc. Ass'n v. Brown*, 74 L. T. 283.

But see *Mahony v. East Holyford Mining Co.*, L. R. 7 H. L. 869.

⁴ *Murray v. Bush*, L. R. 6 H. L. 37, 76-77.

⁵ *Staffordshire Gas & Coke Co.*, 66 L. T. 413.

⁶ *Portuguese Consolidated Mines*, 42 Ch. D. 160.

⁷ *Supra*, §§ 1473 et seq.

⁸ *British Asbestos Co. v. Boyd* (1903), 2 Ch. 439.

⁹ *Dawson v. African, etc. Co.* (1898), 1 Ch. 6; *Briton Medical, etc. Ass'n v. Jones*, 61 L. T. 384 (overruling dictum in *Harben v. Phillips*,

facto directors are to be treated for all intents and purposes as if they were legitimate officers, so that where a shareholder is authorized to convene a general meeting by addressing a notice to the board of directors, notice addressed to *de facto* directors is sufficient.¹

§ 1483. **Successors of De Facto Directors — Holding over.** — As the acts of *de facto* directors are valid, they are competent to exercise any power of nominating their successors which may be vested in the directors by the corporation's charter; and successors chosen on such nomination become *de jure* directors.² On the other hand, where it is provided that at a regular general meeting all the directors shall retire, and that retiring directors whose successors are not duly elected shall continue in office, *de facto* directors are not put in office *de jure* because the regular general meeting fails to elect their successors.³

§ 1484. **Presumption that acting Directors were legally elected — Distinguished from Doctrine of De Facto Directors.** — The doctrine as to *de facto* directors presupposes that some defect in their appointment has been proved; but another principle of law of healing effect is that persons acting publicly as officers of a corporation are presumed rightfully in office.⁴ This is true even on direct proceedings to test their title.⁵ So, when a person is proved to have been an officer of a corporation sixteen years before, he will be presumed still to continue in office.⁶

§ 1485. **Estoppel to assert Invalidity of irregular Acts of Directors.** — Another principle on which acts of directors that are

23 Ch. D. 14, 27-28); *British Asbestos Co. v. Boyd* (1903), 2 Ch. 439.

¹ *Foss v. Harbottle*, 2 Hare 461. Cf. *Transport, Ltd. v. Schonberg*, 21 Times L. R. 305, 307 (call of shareholders' meeting issued by a *de facto* director held validated). See also *supra*, § 1195.

² *Smith v. Erb*, 4 Gill (Md.) 437, 462; *Commonwealth ex rel. Jackson v. Smith*, 45 Pa. St. 59.

Cf. *People v. Runkle*, 9 Johns. (N. Y.) 147, 159.

³ *John Morley Bldg. Co. v. Barras* (1891), 2 Ch. 386.

Cf. *Garden Gully Mining Co. v. McLister*, 1 A. C. 39.

⁴ *Selma, etc. R. R. Co. v. Tipton*, 5 Ala. 787; 39 Am. Dec. 344; *Fairfield County Turnpike Co. v. Thorp*, 13 Conn. 173; *National Ins. Co. v. Egleson*, 29 Grant (Can.) 406, 411.

⁵ *State v. Kupferle*, 44 Mo. 154; 100 Am. Dec. 265.

But see *contra*: *State v. Harris*, 3 Ark. 570; 36 Am. Dec. 460.

⁶ *Lucky Queen Mining Co. v. Abraham*, 26 Oreg. 282; 38 Pac. 65.

not in all respects regular, may nevertheless be effective, is that of estoppel. The doctrine of estoppel *in pais* has developed enormously in recent years, and has quite outgrown the narrow definitions of the text-writers and the earlier cases. This fact is nowhere more strikingly illustrated than in the law of corporations. The doctrine of corporations by estoppel which has been approved in so many of the United States is a conspicuous instance. To square the corporation cases with the old principles of equitable estoppel would be a laborious, and in the writer's opinion, an impossible task; and most certainly could not be undertaken here. Suffice it, therefore, to state what seems to be the result of the cases on the subject now in hand without attempting to explain its connection with the law of estoppel in general.

It has been held that one who as director takes part in an allotment of shares is estopped as shareholder from disputing the validity of the allotment.¹ Similarly, a shareholder who, as member of an illegally constituted board of directors, participates in making a call, is estopped from questioning its validity when sued by the company therefor.² So, too, where a meeting of directors for the purpose of calling a shareholders' meeting is convened on an unreasonably short notice, a member of the board who wishes to object should do so at once, in order to enable another board meeting to be duly convened; and if he waits until after the shareholders' meeting has been held, he will not be heard to say that the latter meeting is irregular because the board meeting that issued the call was irregular.³ A shareholder who participates in an election of a larger number of directors than is fixed by the regulations of the company cannot be heard to object on that ground to the validity of a call or assessment levied by the directors so chosen.⁴

¹ *York Tramways Co. v. Willows*, 8 Q. B. D. 685, 696, 699; *Christopher v. Noxon*, 4 Ont. 672.

But cf. *Howbeach Coal Co. v. Teague*, 5 H. & N. 151. See also *Schenectady, etc. Co. v. Thatcher*, 11 N. Y. 102; *People v. Sterling Mfg. Co.*, 82 Ill. 457 (holding that one who has participated in the passage of a by-law cannot question the regularity of the proceeding).

² *Faure Electric Co. v. Phillipart*, 58 L. T. 525. Cf. *Stone v. Great Western Oil Co.*, 41 Ill. 85; *Schenectady, etc. Co. v. Thatcher*, 11 N. Y. 102. *Campbell v. Santa Maria, etc. Co.* (Colo.), 95 Pac. 39.

³ *Browne v. La Trinidad*, 37 Ch. D. 1.

⁴ *Jackson v. Crown Point Mining Co.*, 21 Utah 1; 81 Am. St. Rep. 651; 59 Pac. 238.

§ 1486-§ 1487. *Laches or Acquiescence of Directors as binding the Company.*

§ 1486. **In general.** — That the directors may by laches or acquiescence bind their company is well settled.¹ But it has been doubted whether the corporation can be chargeable with the inaction or laches of its directors unless they have held at least one board meeting. For how, it is said, can the directors, who can only act at a board meeting, bind the company by inaction unless a meeting has been held and the opportunity for acting offered? But if it be true, in accordance with the view advocated above, that a directors' meeting may be dispensed with where the members of the board unanimously concur in any given course, then their failure to act for an unreasonable length of time may fairly be construed as unanimous assent to inaction, and would accordingly bind the company. Hence, it has been held that directors' acquiescence may be imputable to the corporation although no board meeting has been held at which action might have been taken.²

§ 1487. **Necessity for affecting all the Directors with Knowledge of Facts in order that their Laches or Inaction be imputed to Company.** — The cases in which it is sought to bind the corporation by alleged acquiescence are usually cases of supposed silent or implied ratification of acts done on its behalf without authority or irregularly; and cases of that sort may be taken as typical instances of acquiescence. Now, in order that an act may be ratified or acquiesced in by the directors, it is first necessary, in general, to affect them with notice of the circumstances. If the theory advanced in the preceding paragraph as to the ground on which the company is bound by acquiescence of its directors be correct, it is necessary to show, unless a board meeting has been held, that not merely some or even a majority, but that all the directors acquiesced, and consequently that not merely some but all had actual or constructive knowledge of the circumstances. But the courts will not be over nice in such

¹ E. g., *Gibson v. Barton*, L. R. 16 Sup. Ct. 379; *Mining Co. v. 10 Q. B. 329*; *Pittsburgh Ry. Co. v. Anglo-Californian Bank*, 104 U. S. *Keokuk, etc. Bridge Co.*, 131 U. S. 192.
371; 9 Sup. Ct. 770; *Jacksonville*, ² *Miller v. Matthews*, 87 Md. 464; *etc. Ry. Co. v. Hooper*, 160 U. S. 514; 40 Atl. 176.

refinements; and proof of a general knowledge and acquiescence on the part of the directors will be sufficient at least *prima facie*.¹ Moreover, for this purpose, the directors may be charged with notice of any facts which by due attention to their duties they ought to have known.² The tendency of the judges is, and properly, to hold that the company is bound by acquiescence whenever an individual would be, and in respect to this particular subject not to accentuate the principle that a mere majority of the directors cannot bind the corporation unless assembled in a duly convened meeting.³ To determine what is sufficient evidence of ratification, reference must be had to the authorities on the law of agency.

§ 1488. **Knowledge of Directors as Notice to the Company.** — The extent to which directors' knowledge is notice to the company depends primarily on how far the knowledge of an ordinary agent is notice to his principal.⁴ Although upon this latter question the authorities are, unfortunately, in a state of some confusion, still it may safely be laid down that a principal is ordinarily affected with his agent's knowledge only when the latter has acquired it in the scope of his agency. Therefore, the broader an agent's power may be, the greater the possibility that his knowledge will be imputable to his principal; and in the case of a so-called general agent the character of agent is almost inseparable from his personality. Now, although directors have such exceedingly broad powers that they may properly be termed general agents of their company, yet the application to them of the rule of law just stated is limited by their incapacity to act except as a board. In consequence, the corporation is not affected with notice of facts which they learn as directors of another company;⁵ or in the course of their own

¹ *Bibb v. Hall*, 101 Ala. 79, 94; 14 So. 98.

Cf. *Smith v. Bank of New England*, 72 N. H. 4, 9-10; 54 Atl. 385; *Brown v. Crown Gold Milling Co.* (Cal.), 89 Pac. 86, 91.

² *Smith v. Bank of New England* (N. H.), 54 Atl. 385. But see *infra*, § 1538.

³ But see *State ex rel. Schroeder v. Perkins*, 90 Mo. App. 603.

⁴ See *Mechem on Agency*, § 730.

⁵ *Marseilles Extension Ry. Co.*, 7 Ch. 161, 168; *Wardlaw v. Troy Oil Mill*, 74 S. Car. 368; 54 S. E. 658.

But see *Easton Nat. Bank v. American Brick, etc. Co.*, 60 Atl.

private business,¹ or in any other way than as a board.² But if knowledge can be brought home to all the directors, then the company should be affected therewith although it was not communicated at a board meeting;³ for we have seen that directors may bind the company by their unanimous action although no formal meeting is held. Somewhat inconsistent with these doctrines seems to be the rule, which is apparently established, that where notice is formally given to a director for the purpose of communication to his associates, the company is chargeable therewith, whether or not the information was actually communicated to the board.⁴ Wherever a company has become charged with notice of facts known to its directors, it is not relieved from this notice by a change in the personnel of the directorate;⁵ the new board are charged with knowledge of all facts of which their predecessors had notice.

(N. J.) 54, reversed as to some points, 64 Atl. 917.

¹ *Powles v. Page*, 3 C. B. 16; *First Nat. Bank v. Christopher*, 40 N. J. Law 435; 29 Am. Rep. 262; *Schneider v. Sellers*, 84 S. W. Rep. 417; 98 Tex. 380; *Home Savings, etc. Bank v. Peoria Agricultural, etc. Soc.*, 206 Ill. 9; 69 N. E. 17; 99 Am. St. Rep. 132.

Cf. *David Payne & Co.* (1904), 2 Ch. 608 (where the director who acquired the knowledge subsequently acted on behalf of the company in the transaction, but was held to be under no duty to impart his information to his associates).

² Cf. *Buttrick v. Nashua, etc. R. R. Co.*, 62 N. H. 413; 13 Am. St. Rep. 578; *Possell v. Smith* (Colo.), 88 Pac. 1064 (where a corporation was affected with notice communi-

cated to a majority of the directors although no board meeting was had).

³ *Kelsey v. Nat. Bank*, 69 Pa. St. 426. Cf. *Brown v. Crown Gold Milling Co.* (Cal.), 89 Pac. 86, 91 (where the knowledge of a mere majority of the directors was imputed to the company); *Yellow Jacket, etc. Co. v. Stevenson*, 5 Nevada 224 (notice to minority of directors held not imputable to company, query as to notice to a majority or all of the board).

⁴ *North British Ins. Co. v. Hallet*, 7 Jur., n. s., 1263.

Cf. *David Payne & Co.* (1904), 2 Ch. 608.

⁵ *Mechanics Bank v. Seton*, 1 Pet. 299; *U. S. Nat. Bank v. Forstedt*, 90 N. W. 919; 64 Nebr. 855.

CHAPTER XXV

RIGHTS AND EMOLUMENTS OF DIRECTORS

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§ 1489. **In general.** — The rights and emoluments of a directorship are by no means numerous or commensurate with its liabilities and burdens. The more important advantages to

be derived from the office are generally of an indirect nature, consisting chiefly in the dignity attaching to the position in the eyes of the mercantile world, and in the opportunities which it offers for observing the inner workings of the company and for protecting and enhancing the value of its securities, in which the director is apt to have invested. If these advantages are not sufficient to counterbalance the undeniably great hazards and disabilities incident to the office, then the direct pecuniary emolument which it may carry will rarely be sufficient to induce the hesitating director-elect to accept the position.

§ 1490-§ 1501. PECUNIARY COMPENSATION OF DIRECTORS.

§ 1490. **In general — No Agreement of Corporation to pay for Services of Directors implied by the Law.** — Indeed, unless some salary or other remuneration is affirmatively provided for by statute, charter, or the company's regulations, directors are entitled to no pecuniary compensation. This rule is based on the English doctrine that a trustee or other fiduciary is *prima facie* deemed to render his services gratuitously; and although that doctrine has been departed from in the United States where trustees under deeds, wills, or decrees of court are entitled to reasonable compensation, yet the corollary of the doctrine with respect to directors is enforced with the same severity as in England.

Directors cannot, therefore, like ordinary servants or agents, recover for their service *quantum meruit*; ¹ and the rule is the

¹ *Dunston v. Imperial Gas Light Co.*, 3 B. & Ad. 125; *Hutton v. West Cork Ry. Co.*, 23 Ch. D. 654; *Brown v. Republican, etc. Silver Mines*, 17 Colo. 421; 30 Pac. 66; 16 L. R. A. 426; *American Central Ry. Co. v. Miles*, 52 Ill. 174; *Rockford, etc. R. R. Co. v. Sage*, 65 Ill. 328; 16 Am. Rep. 587; *Gridley v. Lafayette, etc. Ry. Co.*, 71 Ill. 200; *Chicago, etc. Co. v. Biddison*, 46 Ill. App. 423; *Barry v. Coffeen, etc. Co.*, 52 Ill. App. 183; *Maux Ferry, etc. Co. v. Branegan*, 40 Ind. 361; *Citizens' Nat. Bank v. Elliott*, 55 Iowa 104; 7 N. W. 470; 39 Am. Rep. 167; *Holland v. Lewiston Falls Bank*, 52 Me. 564; *Sawyer v. Pawner's Bank*, 6 Allen (Mass.) 207; *Adlets v. Shoe Co.*, 84 Mo. App. 288; *Smith v. Putnam*, 61 N. H. 632; *Loan Ass'n v. Stonemetz*, 29 Pa. St. 534; *Kilpatrick v. Penrose, etc. Co.*, 49 Pa. St. 118; 88 Am. Dec. 497; *Martindale v. Wilson-Cass Co.*, 134 Pa. St. 348; 19 Atl. 680; 19 Am. St. Rep. 706; *Hall v. Vermont, etc. R. R. Co.*, 28 Vt. 401, 409; *Santa Clara Mining Ass'n v. Meredith*, 49 Md. 389; 33 Am. Rep. 264; *Wood v. Lost Lake Mfg. Co.*, 23 Oreg. 20; 23 Pac. 848; 37 Am. St. Rep. 651; *Burns v. Commencement Bay Co.*, 4 Wash. 558; 30 Pac. 668, 709; *Reeve v.*

same where although the regulations provide that they shall receive such compensation as the shareholders (or the directors themselves) may determine, yet no compensation is ever actually so fixed.¹ The extent to which they may recover for services rendered outside the duties of their office is considered below.² Where they have performed their duties gratuitously, any subsequent promise of the company to pay therefor is *nudum pactum*, and therefore unenforceable against the corporation or its creditors.³

§ 1491-§ 1498. *Salary or Compensation provided for in the Company's Regulations.*

§ 1491. **In general.** — Where compensation is allowed to the directors by the company's charter or regulations, they are entitled to it *ex debito*, and a promise not to claim it has been said to be mere *nudum pactum*;⁴ and an attempt of the company to

Harris, 50 S. W. Rep. 658 (Tenn.); *York Life Ins. Co.*, 66 Hun (N. Y.) *Grafner v. Pittsburg, etc. Ry. Co.*, 75; 20 N. Y. Supp. 788. 207 Pa. St. 217; 56 Atl. 426.

For a case where a contract to pay a certain salary was implied from acquiescence of the corporation, see *Church v. Church Cement Co.*, 75 Minn. 85; 77 N. W. 548.

¹ *Illinois Linen Co. v. Hough*, 91 Ill. 63; *Bolt & Iron Co.*, 14 Ont. 211.

Cf. *Eagle, etc. Mfg. Co. v. Browne*, 58 Ga. 240; *Grundy v. Pine Hill Coal Co.*, 9 S. W. Rep. 414 (Ky.); *Missouri River R. R. Co. v. Richards*, 8 Kans. 101; *Schickel v. Berryville Land Co.*, 99 Va. 88, 96-97; 37 S. E. 813; *National Loan, etc. Co. v. Rockland Co.*, 94 Fed. 335; 36 C. C. A. 370; *Steam Dredge No. 1*, 87 Fed. 760; *Metropolitan Rubber Co. v. Place*, 147 Fed. 90; 77 C. C. A. 262; *Caridad Copper Mining Co.* (1902), 2 K. B. 44 (where the directors were to fix the time of payment).

² *Infra*, § 1503-§ 1507.

³ *Martindale v. Wilson-Cass Co.*, 134 Pa. St. 348; 19 Atl. 680; 19 Am. St. Rep. 706; *Beers v. New*

Cf. *Wood v. Lost Lake Mfg. Co.*, 23 Ore. 20; 23 Pac. 848; 37 Am. St. Rep. 651 (where the subsequent resolution was by the directors and not by the shareholders).

But see *First Nat. Bank v. Drake*, 29 Kans. 311, 330; 44 Am. Rep. 646 (semble); *Beach v. Stouffer*, 84 Mo. App. 395; *Wickersham v. Crittenden*, 110 Cal. 332; 42 Pac. 893 (a case of ratification of an antecedent contract made on the company's behalf but without due authority).

⁴ *Lambert v. Northern Ry.*, 18 W. R. 180. Cf. *Wood's Ship Co.*, 62 L. T. 760.

But see *McConnell's Case* (1901), 1 Ch. 728; *Bowler v. American Box Strap Co.*, 22 N. Y. Misc. 335; 49 N. Y. Supp. 153. See also *Thompson Co. v. Brook*, 14 N. Y. Supp. 370; 37 N. Y. St. Rep. 506.

That mandamus will not lie by a director to compel his co-directors to fix the plaintiff's compensation in pursuance of the company's regulations, see *Dashwood v. Cornish*, 13 Times L. R. 337.

rescind a resolution fixing an officer's salary after he has accepted the office would clearly be nugatory.¹ The salaries of corporate officers are not "wages" within the meaning of statutes exempting the "wages of laborers and employees" from attachment.² A bonus to induce a man to accept office should be distinguished from salary.³

§ 1492. **Performance of Duties of the Office as Condition to Recovery of Salary.** — There is a difference of opinion whether a director's right to his salary is subject to the implied condition that he must perform the services expected of him. Thus, according to some authorities, a director's right to his salary is lost if he is prevented from performing the duties of the office even without his own fault.⁴ Thus, it has been held that no further claim for salary can accrue after the appointment of a receiver for the corporation,⁵ or, it seems, after a sale of all its assets and business.⁶ So, it has been held that an officer is not entitled to his salary for a period during which he was incapacitated by illness.⁷ *A fortiori*, according to these authorities, the director's right to his salary is forfeited when his failure to perform the duties of the office is due to his own default. Thus, a Rhode

¹ *Kimball v. New England, etc.* 164 Ill. 427; 45 N. E. 954; 56 Am. Grate Co., 168 Mass. 32; 46 N. E. St. Rep. 203.

² *South & North Ala. R. R. Co. v. Falkner*, 49 Ala. 115.

Cf. Grubbs-Wiley Grocery Co., 96 Fed. 183 (holding that the claim for salary of a director of a bankrupt corporation who had acted as its general manager is not preferred under the U. S. Bankrupt Act of 1898 as "wages due to workmen, clerks, or servants"). See also *infra*, § 1506.

But see *Langley v. Langley*, 31 Ont. R. 254 (holding that claim of president for salary is entitled to preference under statute providing for payment of "wages or salary of all persons in the employment" of the corporation in priority to general creditors); *Bwinger v. Evening Union Printing Co.* (N. J.), 65 Atl. 482 (stated *infra*, § 1506).

³ *McNulta v. Corn Belt Bank*, 438; 90 N. W. 973.

⁴ *Cf. Roberts v. Stanton Co.* (Wash.), 94 Pac. 647 (where plaintiff was prevented from acting by another officer).

⁵ *Commonwealth v. Eagle Fire Ins. Co.*, 14 Allen (Mass.) 344; *Lenoir v. Linville Imp. Co.*, 126 N. Car. 922; 36 S. E. 185; 5 L. R. A. 146; *Williamson County Bank v. Roberts-Buford, etc. Co.*, 101 S. W. 421.

⁶ *Long Island Ferry Co. v. Terbell*, 48 N. Y. 427.

Cf. Simonson v. New York City Ins. Co., 141 N. Y. 12; 35 N. E. 969; *Rodney v. Southern R. R. Ass'n*, 3 N. Y. St. Rep. 564; s. c. 14 Daly 70; *Union Compress Co. v. Douglass*, 60 Ark. 591; 31 S. W. 455.

But see *Potts v. Rose Valley Mills*, 167 Pa. St. 310; 31 Atl. 655.

⁷ *Raley v. Victor Co.*, 86 Minn.

Island case holds that directors who are guilty of fraud and breach of trust forfeit their right to their salaries.¹ No doubt, in such cases, the company should be allowed to set off or recoup the damages sustained from the breach of trust, but unless the breach of duty goes to the essence of the contract between the company and the director the latter should not suffer a complete forfeiture of his right to compensation for services actually rendered.

On the other hand, it has been held in England that a director is entitled to his stipulated compensation even though he may have been appointed receiver in a suit to enforce the security of holders of bonds or debentures and may in the latter capacity have managed the business of the company and received full compensation, or commissions, for so doing.² It has been held that the right to the appointed salary is not taken away by absence or inattention to duty, whether caused by illness³ or otherwise.⁴

The fact that a director had been concerned secretly in contracts with the company and that he would not have been elected if the circumstances had been fully disclosed does not disentitle him to his salary.⁵ But money which was paid as compensation to a person who was supposed to be a director but who in fact had vacated his office by becoming interested in contracts with the company may be recovered back.⁶

§ 1493. **In cases where no Profits have been earned.** — Directors may ordinarily pay themselves their stipulated compensation although no profits have been earned.⁷ Where, however, by the terms of a company's regulations the directors are entitled to compensation only after a dividend shall have been paid

¹ *Eaton v. Robinson*, 19 R. I. 146; 31 Atl. 1058; 32 Atl. 339; 29 L. R. A. 100.

Cf. *Moses v. Ocoee Bank*, 1 Lea (Tenn.) 398, 410-411.

² *South Western of Venezuela Ry. Co.* (1902), 1 Ch. 701.

³ *Davis v. Memphis City Ry. Co.*, 22 Fed. 883; *Brown v. Galveston Wharf Co.*, 92 Tex. 520; 50 S. W. 126.

⁴ *Finley Rubber, etc. Co. v. Finley*, 32 Atl. Rep. 740 (N. J. Ch.).

⁵ *Bodega Co.* (1904), 1 Ch. 276, 288 (headnote inadequate).

⁶ *Bodega Co.* (1904), 1 Ch. 276.

⁷ *Lundy Granite Co., Lewis's Case*, 20 W. R. 519; 26 L. T. 673; *Commercial Life Ass.*, 27 L. J. Ch. 803; *Mills v. Hendershot* (N. J.), 62 Atl. 542; *Lambert v. Northern Ry.*, 18 W. R. 180.

But see *Burns v. Beck*, 83 Ga. 471, 496; 10 S. E. 121. Cf. *McCracken v. Halsey Fire Engine Co.*, 57 Mich. 361; 24 N. W. 104; *Trust & Deposit Co. v. Spartanburg Water Co.*, 97 Fed. 409.

to the shareholders, they must refund all money paid them as remuneration during a period within which, no profits having been earned, dividends were declared and paid out of capital;¹ but a contrary result has been reached where the directors in approving the accounts which showed the dividends to be payable acted honestly and upon a not unreasonable overvaluation of the company's assets.²

§ 1494. **In Winding-up or Liquidation.** — In respect to their stipulated salaries which have been justly earned, directors stand in the position of creditors even in liquidation or winding-up proceedings. Accordingly, sums owing to them for arrears of salary are not due to them "in their capacity of members" of the company even where directors are required to be shareholders.³ It should, however, be borne in mind that the payment of directors' salaries when the company is insolvent may be bad as a fraudulent preference under bankrupt laws or winding-up acts.⁴

§ 1495. **Whether annual Salaries are apportionable for Fraction of a Year.** — Where directors are entitled to an annual salary, a question has been raised whether they may receive a proportionate part for serving for a fraction of a year. It has been held that directors' salaries are not apportionable, and that consequently, where a certain sum is payable for a year's service, a director who ceases to serve during the year is entitled to nothing. This was held where the year was cut short by the director's forfeiture of his office for non-attendance,⁵ by his resignation,⁶ and by the voluntary winding-up of the company.⁷ On the other

¹ *Oxford Bldg. Society*, 35 Ch. D. 502; *Leeds Estate, etc. Co. v. Shepherd*, 36 Ch. D. 787.

² *Peruvian Guano Co.* (1894), 3 Ch. 690.

Cf. *Mills v. Hendershot* (N. J.), 62 Atl. 542 (where the payment of salary out of capital, having been acquiesced in by the shareholders, could not be attacked by the receiver of the company).

³ *Dale & Plant*, 43 Ch. D. 255; *Ex parte Beckwith* (1898), 1 Ch. 324; *A 1 Biscuit Co.*, W. N. (1899) 115.

Contra: *Ex parte Cannon*, 30 Ch. D. 629, which it is submitted, is

substantially overruled by the three cases last cited, in spite of the attempts at distinguishment.

⁴ *Washington Diamond Mining Co.* (1893), 3 Ch. 95.

Cf. *Leeds Estate, etc. Co. v. Shepherd*, 36 Ch. D. 787.

⁵ *McConnell's Claim* (1901), 1 Ch. 728.

Cf. *Boston Deep Sea, etc. Co. v. Ansell*, 39 Ch. D. 339.

⁶ *Inman v. Ackroyd & Best* (1901), 1 K. B. 613; *Central De Kaap Gold Mines*, 69 L. J. Ch. 18.

⁷ *Salton v. New Beeston, etc. Co.* (1899), 1 Ch. 775

hand, it has been held that where directors are entitled to an annual salary they may pay themselves on account a proportionate part before the expiration of the first year after the incorporation of the company.¹

§ 1496. **Claim for Damages against Company for going into Liquidation.** — Except under very unusual regulations, a director will hardly be entitled to damages from the company because it goes into liquidation and thus prevents him from earning a salary during the residue of his term.² Perhaps the contract would be assimilated to a contract of personal service which is terminated on the demise of either party.³

§ 1497. **Whether Trustee of Shares is accountable to Cestui que Trust for Salary as Director which the trust Shares enabled him to procure.** — A person who holds shares as trustee and who by virtue of such ownership procures an election as director — for example, where his election is effected by his own vote as trustee or where the trust shares constitute his only qualification shares as director — may perhaps be guilty of a breach of duty owing to the *cestui que trust* and may perhaps be liable to removal by a court of equity,⁴ but as against the company and its other shareholders he is entitled to his salary as director.⁵ Indeed, it has been held that the *cestui que trust* cannot require him to account for the salary as a profit made out of the trust property;⁶ the

¹ *Wood's Ships Woodite, etc. Co., Roberts-Buford, etc. Co.* (Tenn.), 101 62 L. T. 760.

Cf. *Central De Kaap Gold Mines*, 69 L. J. Ch. 18.

² See *Jones v. Vance Shoe Co.*, 92 Ill. App. 158, 161, where a receiver for the company was appointed at the complaining director's own instance.

Cf. *Eddy v. Co-operative Dress Ass'n*, 3 N. Y. Civ. Proc. Rep. 442; *Lenoir v. Linville Imp. Co.*, 126 N. Car. 922; 36 S. E. 185; 5 L. R. A. 146; *People v. Globe Mut. Life Ins. Co.*, 91 N. Y. 174; *Loucheim v. Clawson Printing, etc. Co.*, 12 Pa. Super. Ct. 55; *Busell Trimmer Co. v. Coburn*, 188 Mass. 254; 74 N. E. 334; 69 L. R. A. 821; *Conklin v. U. S. Shipbuilding Co.*, 143 Fed. 631; *Williamson County Bank v. 65.*

S. W. 421.

But see *Spader v. Mural Decoration Mfg. Co.*, 47 N. J. Eq. 18; 20 Atl. 378; *Reid v. Explosives Co.*, 19 Q. B. D. 264; *Yelland's Case*, 4 Eq. 350; *Ex parte Logan*, 9 Eq. 149; *Ex parte Clark*, 7 Eq. 550.

See also *supra*, § 1492.

³ But see *Midland Counties Dist. Bank v. Attwood* (1905), 1 Ch. 357 (holding that the contract is not terminated by the passage of a resolution for a voluntary winding-up).
⁴ *Re Hirsch*, 116 N. Y. App. Div. 367.

⁵ *Hirsch v. Jones*, 115 N. Y. App. Div. 156.

⁶ *Dover Coalfield Extension* (1907), 2 Ch. 76, affirmed (1908), 1 Ch.

salary, it is held, is paid as compensation for his services to the company and is not a profit obtained by use of the trust shares.

§ 1498. **Rights of De Facto and disqualified Directors to Salary.** — In other places, consideration will be found of the right to compensation of a *de facto* director,¹ or director serving without the requisite qualification shares.²

§ 1499. **Power of Directors to vote themselves Compensation to which they would not otherwise be entitled.** — The extent to which directors have power to vote to themselves other compensation than that, if any, provided for by the company's regulations will be considered below in connection with the disabilities of directors.³

§ 1500. **Gratuities voted to Directors by Shareholders.** — The shareholders, whenever no salary or, in their opinion, an inadequate one is provided for directors, may vote them a gratuity in consideration of past services to the same extent as in the case of mere servants.⁴

§ 1501. **Special Contracts with Directors as to their Compensation.** — As to compensation for future services, a corporation may enter into a special contract with its directors-to-be for less or more remuneration than is provided by the regulations.⁵

§ 1502. **Right of Directors to Indemnification for Expenses incurred in the Course of their Duty.** — Although the law does not contemplate that directors shall profit by their office, and although it vigorously opposes all attempts to gain surreptitious advantages therefrom, yet it does not expect that a director who

¹ Supra, § 1479.

² Supra, § 1412.

³ Infra, § 1598-§ 1600.

⁴ Cf. *Figge v. Bergenthal* (Wisc.), 109 N. W. 581; 110 N. W. 798 (holding that a minority shareholder cannot object to the payment of any compensation honestly voted to directors by the majority of the

shareholders); *Normandy v. Ind, Coope & Co.* (1908), 1 Ch. 84.

But see *Paton's Case*, 5 Ont. L. R. 392 (compensation voted to directors without authority of a by-law recovered back).

⁵ *McConnell's Claim* (1901), 1 Ch. 728, distinguishing *Lambert v. Northern Ry.*, 18 W. R. 180.

is guilty of no misconduct shall sustain losses in consequence of his position; and accordingly directors, although not allowed to reap profits from contracts between themselves and the company, are nevertheless entitled to indemnity or reimbursement for losses which they may suffer or expenses to which they may be put on behalf of the company. This, too, like so much of the law of directors, is a mere application of long-established principles in the law of agency and of trusts. Thus, where a director makes a contract in his own name but really on behalf of his company, he is entitled to be reimbursed by the corporation for all liability thereon to which he may be subjected; and this right survives his removal from office, and is not affected, if the transaction was a reasonable one, by the subsequent disapproval of the contract by the shareholders.¹ In the same way, where a director purchases shares in another corporation in his own name in trust for his own company, the latter must indemnify him against all calls which as nominal holder of such shares he may be compellable to pay.² So, where a lease is taken in the name of a director in trust for the company, the director is entitled to reimbursement for all rent, etc., which he may have been as lessee compelled to pay, and his claim to reimbursement is a prior lien on the lease, coming in ahead of general creditors and also debenture-holders.³ Likewise, a director who permits the company in some exigency to consume or use his property is entitled to recover its fair value.⁴ A director who endorses notes of the corporation and is compelled to take them up has a valid claim for indemnity.⁵ So, also, where directors pay off claims against the company for, so to speak, the honor of the company, they must be reimbursed by the corporation for the sums so expended,⁶ and to the extent of the amounts so

¹ *Gleadow v. Hull Glass Co.*, 19 L. J. Ch. 44.

² *National Financial Co.*, 3 Ch. 791.

³ *Pooley Hall Colliery Co.*, 18 W. R. 201.

⁴ *Rider v. Union Rubber Co.*, 5 Bosw. (N. Y.) 85; *Greensboro, etc. Turnpike Co. v. Stratton*, 120 Ind. 294; 22 N. E. 247.

⁵ *Savage v. Madelia, etc. Warehouse Co.* (Minn.). 108 N. W. 296.

⁶ *Ex parte Sedgwick*, 2 Jur., n. s., Cf. *Deane v. Hodge*, 35 Minn. 146; 949; *International Life Ass. Soc.*, 39 27 N. W. 917; 59 Am. Rep. 321 L. J. Ch. 271.

paid out they will be subrogated to the rights of the creditors whose claims they discharge.¹ Furthermore, they are entitled to interest on the sums which they have expended in this way in satisfaction of the company's liabilities.²

In one English case, it was held that in such cases, the directors will not be allowed to compete with the general creditors.³

The principle of indemnification for expenses incurred in the service of the company does not extend to such expenses as are necessarily involved in performing the duties of the office. For instance, directors cannot recover from the company their travelling expenses for journeys between their residence and the company's office even if undertaken for the purpose of attending directors' meetings.⁴

§ 1503-§ 1507. *Compensation of Directors for Extra Services.*

§ 1503. **In general.** — The right of directors to compensation for extra services outside the scope of the duties of the office, rests in part upon this principle of indemnification. Some courts have apparently laid down the rule that even for extra services directors are entitled to no compensation in the absence of an express contract therefor prior to the rendition of the services.⁵ But this view, by discriminating between express and implied contracts, is contrary to the analogies of the law. For, as will be explained below, although any special contract between a director and his company acting through his co-directors is,

¹ *Gibbs and West's Case*, 10 Eq. 312; *Ulster Ry. Co. v. Bainbridge*, Ir. Rep. 2 Eq. 190; *Lowndes v. Garnett Gold Mining Co.*, 33 L. J. Ch. 418; *Coe v. New Jersey Midland Ry. Co.*, 31 N. J. Eq. 105, 133-138.

Cf. *Baker's Case*, 1 Dr. & Sm. 55, 65, 66.

² *Ulster Ry. Co. v. Bainbridge*, Ir. Rep. 2 Eq. 190, 203; *Kroegher v. Calivada Colonization Co.*, 119 Fed. 641, 651; 56 C. C. A. 257.

³ *Lowndes v. Garnett Gold Mining Co.*, 33 L. J. Ch. 418.

⁴ *Davies v. Monroe Water Works, etc. Co.*, 107 La. 145, 155-156; 31 So. 694; *Young v. Naval, Military,*

etc. Soc. (1905), 1 K. B. 687 (proceeding on the ground that the travelling expenses must be taken to be included in a salary which was paid to the directors).

⁵ Cf. *Brown v. Republican Silver Mines*, 17 Colo. 421; 30 Pac. 66; 16 L. R. A. 426; *Stout v. Security Trust, etc. Co.*, 82 N. Y. App. Div. 129; 81 N. Y. Supp. 708; *Brophy v. American Brewing Co.*, 211 Pa. 596; 61 Atl. 123; *Home Mixture Guano Co. v. Tillman*, 125 Ga. 172; 53 S. E. 1019. Perhaps all that these cases really mean is that the contract must be implied in fact rather than implied in law.

according to one view, always voidable by the corporation,¹ yet, if the privilege of avoidance be exercised, the company must return the consideration, so that, if the contract be repudiated by the corporation, the director may recover for such services as he may have rendered thereunder *quantum meruit*.² Surely, a director who has performed services which have proved beneficial to the corporation without any express contract for compensation but under such circumstances as naturally to lead him to expect remuneration therefor ought to be in no worse position than one who has rendered similar services under a contract which the law strikes down as constructively fraudulent by reason of his fiduciary position. Accordingly, by the great weight of authority, directors who have rendered to their company services which are clearly outside the scope of their official duties and who can show affirmatively a general understanding that compensation would be given, or circumstances that in law are tantamount to such an understanding, may recover from the company as much as the services have been reasonably worth to it.³ In so holding, the law is not permitting directors

¹ *Infra*, § 1563 et seq., and § 1600.

² *Infra*, § 1595.

³ *Corinne Mill, etc. Co. v. Toponce*, 152 U. S. 405 (headnote inadequate); 14 Sup. Ct. 632; *Fitzgerald, etc. Co. v. Fitzgerald*, 137 U. S. 98 (headnote inadequate); 11 Sup. Ct. 36; *Rockford, etc. R. R. Co. v. Sage*, 65 Ill. 328; 16 Am. Rep. 587; *Ten Eyck v. Pontiac, etc. R. R. Co.*, 74 Mich. 226; 41 N. W. 905; 16 Am. St. Rep. 633; 3 L. R. A. 378; *Shackelford v. New Orleans, etc. R. R. Co.*, 37 Miss. 202; *Chandler v. Monmouth Bank*, 13 N. J. Law 255; *Brown v. Creston Ice Co.*, 113 Iowa 615; 85 N. W. 750; *Greensboro, etc. Turnpike Co. v. Stratton*, 120 Ind. 294; 22 N. E. 247; *Ruby Chief Mining, etc. Co. v. Prentice*, 25 Colo. 4; 52 Pac. 210; *Bagley v. Carthage, etc. R. R. Co.*, 165 N. Y. 179; 58 N. E. 895; *Sargent v. Sargent Granite Co.*, 3 N. Y. Misc. 325; 23 N. Y. Supp. 886; *Jackson v. N. Y. Central R. R. Co.*, 2 Thomp. & C. (N. Y.) 653 (affirmed in 58 N. Y. 623); *Bas-*

sett v. Fairchild, 132 Cal. 637; 64 Pac. 1082; 52 L. R. A. 611; *Bartlett v. Mystic River Corp.*, 151 Mass. 433; 24 N. E. 780; *New Orleans, etc. Co. v. Brown*, 36 La. Ann. 138; 51 Am. Rep. 5; *Olney v. Chadsey*, 7 R. I. 224; *Missouri River R. R. Co. v. Richards*, 8 Kans. 101; *Flynn v. Columbus Club*, 21 R. I. 534; 45 Atl. 551; *Taussig v. St. Louis, etc. R. R. Co.*, 186 Mo. 269; 85 S. W. 378 (services as attorney at law); *Lowe v. Ring*, 115 Wisc. 575; 92 N. W. 238 (services as attorney at law); *Waters v. American Finance Co.*, 102 Md. 212; 62 Atl. 357 (services as selling-agent or broker); *Bogart v. N. Y., etc. R. Co.*, 102 N. Y. Supp. 1093 (services as engineer).

But see *contra*: *North Eastern Ry. Co. v. Jackson*, 19 W. R. 198.

Cf. *Henry v. Rutland, etc. R. Co.*, 27 Vt. 435; *Hall v. Vermont, etc. R. R. Co.*, 28 Vt. 401; *Triplett v. Fauver*, 103 Va. 123, 130; 48 S. E. 875; *Henry v. Michigan Sani-*

to make a profit out of their position, but is merely protecting them from loss by allowing them bare compensation.

§ 1504. **What are deemed Extra Services — Services as President, Vice-President, Secretary, Treasurer, etc.** — In the application of this principle, however, every intendment will be made against the director. For instance, services as the company's president, vice-president, secretary, treasurer, etc., in the ordinary line of the duties pertaining to those offices will not be deemed such extra services as will entitle a director, under the above rule, to compensation *quasi ex contractu*.¹ Consequently, for services as such officers, no recovery can be had —

tarium, etc. Ass'n (Mich.), 110 N. W. 523 (depending on a special statute providing that no trustee of a charitable corporation should be entitled to compensation except under a special contract made by the board of trustees).

¹ *Crumlish v. Central Imp. Co.*, 38 W. Va. 390; 18 S. E. 456; 45 Am. St. Rep. 872; 23 L. R. A. 120 (secretary-treasurer); *West Point Tel., etc. Co. v. Rose*, 76 Miss. 61; 23 So. 629 (secretary); *Holder v. Lafayette, etc. Ry. Co.*, 71 Ill. 106; 22 Am. Rep. 89 (treasurer); *St. Louis, etc. R. R. Co. v. O'Hara*, 177 Ill. 525; 52 N. E. 734; 53 N. E. 118 (president); *McAvity v. Lincoln, etc. Co.*, 82 Me. 504; 20 Atl. 82 (president); *Citizens' Nat. Bank v. Elliott*, 55 Iowa 104, 107; 7 N. W. 470; 39 Am. Rep. 167 (vice-president); *Field v. Union Box Co.*, 2 Wkly. Notes Cas. (Pa.) 426 (superintendent); *Reeve v. Harris*, 50 S. W. Rep. 658 (Tenn.) (treasurer); *Bolt & Iron Co.*, 14 Ont. 211 (managing director); *Jones v. Vance Shoe Co.*, 92 Ill. App. 158 (secretary and manager); *Pfeiffer v. Landsberg Brake Co.*, 44 Mo. App. 59 (secretary); *Brown v. Republican, etc. Silver Mines*, 17 Colo. 421; 30 Pac. 66; 16 L. R. A. 426 (managing director); *Hodges v. Rutland, etc. R. R. Co.*, 29 Vt. 220 (member of executive committee); *Steam Dredge No. 1*, 87 Fed. 760 (chief engineer);

Merrick v. Peru Coal Co., 61 Ill. 472 (president); *Lowe v. Ring*, 101 N. W. 698; 123 Wisc. 370 (president); *McConnell v. Combination Mining, etc. Co.*, 30 Mont. 239; 76 Pac. 194; 104 Am. St. Rep. 703; 31 Mont. 563; 79 Pac. 248 (president, vice-president, and treasurer); *Stout v. Security Trust, etc. Co.*, 82 N. Y. App. Div. 129; 81 N. Y. Supp. 708 (vice-president and general manager); *Adlets v. Progressive Shoe Co.*, 84 Mo. App. 288 (president); *Home Mixture Guano Co. v. Tillman*, 125 Ga. 172; 53 S. E. 1019 (president).

But see contra: *Gardner v. Butler*, 30 N. J. Eq. 702 (president); *First Nat. Bank v. Drake*, 29 Kans. 311, 330; 44 Am. Rep. 646 (seemable); *Harris v. Leming Harris, etc. Works* (Tenn.), 43 S. W. Rep. 869 (superintendent); *Missouri River R. R. Co. v. Richards*, 8 Kans. 101 (headnote inadequate) (secretary); *Bassett v. Fairchild*, 132 Cal. 637; 64 Pac. 1082; 52 L. R. A. 611 (vice-president and manager); *Rogers v. Hastings, etc. Ry. Co.*, 22 Minn. 25 (secretary, land commissioner, and solicitor); *Severson v. Bimetallic, etc. Co.*, 18 Mont. 13; 44 Pac. 79 (superintendent); *Felton v. West Iron, etc. Co.*, 16 Mont. 81; 40 Pac. 70 (superintendent of mines); *Gumaer v. Cripple Creek, etc. Co.* (Colo.), 90 Pac. 81, 86 (president acting as general manager).

at least not unless compensation was agreed upon by competent authority prior to the rendition of the services.¹

§ 1505. **Burden of Proof on the Director claiming Compensation.** — Moreover, the authorities generally hold that any extra services are presumptively gratuitous and that the burden rests on the director to show that they were rendered with an understanding that he should be paid therefor, or under circumstances sufficient to lead him to that belief.² In every case the burden is on the director to show also the value of the services rendered by him.³

§ 1506. **Nature of Claim.** — *Whether a Claim for Wages.* — The right of members of the board of directors for extra services may, according to the nature of the services, be entitled to priority under a statute giving priority to claims of laborers and employees for their wages.⁴

§ 1507. **Effect of Vote of Compensation by Co-directors.** — The effect of a special vote of the co-directors providing a salary or compensation for a director who has rendered or is to render extra services is considered below.⁵

§ 1508-§ 1509. *Right of Director to the non-pecuniary Advantages of the Office.*

§ 1508. **Remedies of Director whose Title to the Office is denied** — **Trying Title to the Office.** — As stated above, the most valu-

¹ *Haz v. Davis Mill Co.*, 39 Mo. App. 453, and cases cited in last note. Cf. *National Loan, etc. Co. v. Rockland Co.*, 94 Fed. 335; 36 C. C. A. 370.

² *Eakins v. Am. White Bronze Co.*, 75 Mich. 568; 42 N. W. 982; *Gill v. New York Cab Co.*, 48 Hun (N. Y.) 524; 1 N. Y. Supp. 202; *Brown v. Republican, etc. Silver Mines*, 17 Colo. 421; 30 Pac. 66; 16 L. R. A. 426; *Stout v. Security Trust, etc. Co.*, 82 N. Y. App. Div. 129; 81 N. Y. Supp. 708.

Cf. *Pew v. First Nat. Bank*, 130 Mass. 391; *Pfeiffer v. Landsberg Brake Co.*, 44 Mo. App. 59; *Rose v. Carbonating Co.*, 60 Mo. App. 28; *Utico Ins. Co. v. Bloodgood*, 4 Wend.

(N. Y.) 652; *Farmers' L. & T. Co., v. Housatonic R. R. Co.*, 152 N. Y. 251; 46 N. E. 504; *Hodges v. Rutland, etc. R. R. Co.*, 29 Vt. 220; *Levissee v. Shreveport City R. R. Co.*, 27 La. Ann. 641; *Olney v. Chadsey*, 7 R. I. 224.

But see *Shackelford v. New Orleans, etc. R. R. Co.*, 37 Miss. 202; *Bassett v. Fairchild*, 132 Cal. 637; 64 Pac. 1082; 52 L. R. A. 611; *Baines v. Coos Bay Nav. Co.*, 41 Oreg. 135 (headnote inadequate); 68 Pac. 397.

³ *Greathouse v. Martin* (Tex.), 94 S. W. 322.

⁴ *Buvinger v. Evening Union Printing Co.* (N. J.), 65 Atl. 482.

⁵ *Infra*, § 1600.

able rights of a director grow out of the opportunities that his position affords of becoming cognizant with the real condition and prospects of the company; and hence a personal wrong is suffered by a director who is excluded by his associates from their meetings and consultations, and from participation in the management of the corporation. Accordingly, one who has been legally elected a director but whose title to the position is denied may maintain mandamus against the company to compel his admission into the office;¹ or, in some jurisdictions, *quo warranto* will lie on his relation against a usurper.² Where several directors claim to have been excluded illegally from their offices, they should not join in one application for

¹ *Regina v. Government Stock Investment Co.*, 3 Q. B. D. 442. See also *State ex rel. Ryan v. Cronan*, 23 Nevada 437; 49 Pac. 41; *Curtis v. McCullough*, 3 Nevada 202; *Journal Pub. Club*, 30 N. Y. Misc. 326; 63 N. Y. Supp. 465.

But cf. *Attorney-General v. Albion Academy*, 52 Wisc. 469; 9 N. W. 391; *Smith v. Erb*, 4 Gill (Md.) 437.

See *Am. Ry. Frog Co. v. Haven*, 101 Mass. 398, where mandamus was granted on an application in the name of the company, the proceeding being authorized by the rightful board of directors, to compel a usurping board to surrender the books and papers pertaining to the office.

² *Commonwealth v. Smith*, 45 Pa. St. 59 (semble); *Attorney-General v. Looker*, 111 Mich. 498, 508; 69 N. W. 929; 56 L. R. A. 947; *People v. Tibbets*, 4 Cow. (N. Y.) 358; *Commonwealth v. Arrison*, 15 Serg. & R. (Pa.) 127; 16 Am. Dec. 531; *Commonwealth v. Graham*, 64 Pa. St. 339; *Davidson v. State*, 20 Fla. 784; *Creek v. State*, 77 Ind. 180; *Barna v. Kirczow* (N. J.), 63 Atl. 611 (semble); *Hankins v. Newell* (N. J.), 66 Atl. 929.

But see *Crawford v. State*, 52 Oh. St. 62; *State ex rel. Ryan v. Cronan*, 23 Nevada 437; 49 Pac. 41; *Le*

Bosquet v. Myers (Ind. Ty.), 103 S. W. 770 (statute providing new remedy as substitute for *quo warranto* held not to apply to offices in a private corporation).

A judgment for the defendant in such a *quo warranto* proceeding will not be reversed although error was committed at the trial if the term of office has expired and a successor has been elected before the hearing in the appellate court. *State v. Tudor*, 5 Day (Conn.) 329; 5 Am. Dec. 162. Contra, where the judgment below was in favor of the government: *Juker v. Commonwealth ex rel. Fisher*, 20 Pa. St. 484, 492. But the fact that the term of office will probably expire before a trial of the case can in ordinary course be had is no objection to the assumption of jurisdiction by the court of first instance. *People v. Tibbets*, 4 Cow. (N. Y.) 358. It is no answer to such a *quo warranto* proceeding that the defendant has resigned, and a successor been elected. *State v. McDaniel*, 22 Oh. St. 354.

Quo warranto has also been allowed to oust a usurping director on the relation of shareholders whose votes had been improperly rejected at the election. *Commonwealth v. Stevens*, 168 Pa. St. 582; 32 Atl. 111. Cf. *State ex rel. Mitchell v. Horan*, 22 Wash. 197; 60 Pac. 135.

the writ of mandamus, since their rights are several and not joint.¹

A court of equity has been held to have no jurisdiction to entertain a bill, filed by persons claiming to be directors against the company and another set of persons claiming to be directors, to determine who has the better right to the office, unless some special ground of equitable jurisdiction, such as fraud, be present, or unless the question arises incidentally in the course of a case over which the court already has jurisdiction.² But much might be said against so closely limiting the jurisdiction of chancery.³

It has been held that title to a corporate office cannot be tried in an action of replevin brought in the name of the corporation against the claimant for the recovery of books and papers of the company.⁴

¹ *U. S. v. McKelden*, MacA. & Mack. (D. C.) 162, 168 (semble).

² *Kean v. Union Water Co.*, 52 N. J. Eq. 813; 46 Am. St. Rep. 538; 31 Atl. 282.

Cf. *Johnston v. Jones*, 23 N. J. Eq. 216; *Hussey v. Gallagher*, 61 Ga. 86; *Jenkins v. Baxter*, 160 Pa. St. 199; 28 Atl. 682; *New England, etc. Ins. Co. v. Phillips*, 141 Mass. 535, 544-546; 6 N. E. 534; *Nathan v. Tompkins*, 82 Ala. 437; 2 So. 747; *Hartt v. Harvey*, 32 Barb. (N. Y.) 55; *Moses v. Tompkins*, 84 Ala. 613; 4 So. 763; *Pond v. Vermont, etc. R. R. Co.*, Fed. Cas. No. 11, 264 (p. 975); *Perry v. Tuskaloosa, etc. Co.*, 93 Ala. 364; 9 So. 217; *Elliott v. Sibley*, 101 Ala. 344; 13 So. 500; *Supreme Lodge v. Simering*, 88 Md. 276; 40 Atl. 723; 71 Am. St. Rep. 409; 41 L. R. A. 720; *Hullman v. Honcomp*, 5 Oh. St. 237; *Newcastle, etc. Co. v. Bell*, 8 Blackf. 584; *Carmel, etc. Co. v. Small*, 150 Ind. 427; 47 N. E. 11; 50 N. E. 476; *Schmidt v. Pritchard* (Iowa), 112 N. W. 801; *Bedford Springs Co. v. McMeen*, 161 Pa. St. 639; 29 Atl. 99; *Hughes v. Parker*, 20 N. H. 58 (denying equitable jurisdiction to pass on the question even when raised collaterally in the course of a suit); *Blinn*

v. Riggs, 110 Ill. App. 37; *Crow v. Florence Ice, etc. Co.*, 39 So. 401; 143 Ala. 541; *Barna v. Kirczow*, (N. J.), 63 Atl. 611; *Davidson v. Grange*, 4 Grant (Can.) 377 (jurisdiction sustained in a case of fraud).

³ Cf. *Haskell v. Read*, 93 N. W. 997; 96 N. W. 1007; 68 Nebr. 107.

A bill in the company's name to enjoin persons wrongfully claiming to be directors from acting as such, has been sustained. *Humboldt Driving Park v. Stevens*, 34 Nebr. 528; 52 N. W. 568; 33 Am. St. Rep. 654 (but cf. *Kean v. Union Water Co.*, 52 N. J. Eq. 813; 46 Am. St. Rep. 538; 31 Atl. 282); *Garmire v. Am. Mining Co.*, 93 Ill. App. 331. So also a bill for the same purpose filed by a shareholder whose votes had been wrongfully rejected at the election will lie. *Reynolds v. Bridenthal*, 57 Nebr. 280; 77 N. W. 658. Cf. *Schmidt v. Mitchell*, 101 Ky. 570; 41 S. W. 929; 72 Am. St. Rep. 427; *Wright v. Central, etc. Co.*, 67 Cal. 532; 8 Pac. 70; *Putnam v. Sweet*, 1 Chand. (Wisc.) 286, 333-337; *Herman v. Rhode*, 34 Hun (N. Y.) 161; *Gilchrist v. Collopy*, 82 S. W. 1018; 26 Ky. Law Rep. 1003.

⁴ *Standard Gold Mining Co. v. Byers*, 31 Wash. 100; 71 Pac. 766.

In some states, summary statutory remedies are provided for trying title to corporate offices, and the existence of such remedies has been deemed an additional reason against the assumption of jurisdiction over such questions by a court of chancery.¹

§ 1509. **Remedies of Director who, although his Title to the Office is not denied, is excluded from Board Meetings, prevented from seeing the Company's Books, etc.** — A director whose right to the office is not denied may sustain a bill in equity to enjoin his colleagues from excluding him from board meetings;² such exclusion is a wrong to him individually as well as to the corporation. But the relation of a director to his corporation is so close and the importance of mutual confidence between himself and the shareholders so great, that a court of equity, for somewhat the same reasons that deter it from specifically enforcing a contract of personal service, will refuse to lend its aid to force upon an unwilling company a director whom the shareholders have pronounced unacceptable, even though he may be legally entitled to the office.³ A director cannot by mandamus compel his associates to allow him "an equal share and control in the management and direction" of the company, where no

Cf. *Austin Mining Co. v. Gemmel*, 10 Ont. 696, 705.

But see *Dartmouth College v. Woodward*, 4 Wheat. 518 (an action of trover).

¹ *Mickles v. Rochester City Bank*, 11 Paige (N. Y.) 118; 42 Am. Dec. 103; *Carmel, etc. Co. v. Small*, 150 Ind. 427, 429 (headnote inadequate); 47 N. E. 11; 50 N. E. 476. Cf. *Hudson River, etc. R. R. Co. v. Hay*, 14 Abb. Pr., n. s. (N. Y.), 191.

A statutory proceeding for testing the validity of elections of directors cannot be resorted to to determine the validity of an appointment to fill a casual vacancy by the continuing members of the board. *Wickersham v. Brittan*, 93 Cal. 34; 28 Pac. 792.

See further as to statutory remedies, *Syracuse, etc. R. R. Co.*, 91 N. Y. 1.

² *Pulbrook v. Richmond Consol., etc. Co.*, 9 Ch. D. 610; *Munster v. Cammell Co.*, 21 Ch. D. 183; *Su-*

preme Lodge v. Simering, 88 Md. 276; 40 Atl. 723; 71 Am. St. Rep. 409; 41 L. R. A. 720; *Kyshe v. Alturas Gold*, 4 Times L. R. 331; *Foster v. Greenwich Ferry Co.*, 5 Times L. R. 16.

³ *Bainbridge v. Smith*, 41 Ch. D. 462; *Harben v. Phillips*, 23 Ch. D. 14.

Cf. *Shulman v. Star Suburban Realty Co.*, 113 N. Y. App. Div. 739; 99 N. Y. Supp. 419 (where relief was denied on account of the indefiniteness of the complaint); *Jones v. Williams*, 37 L. R. A. 682; 139 Mo. 1; 39 S. W. 486; 40 S. W. 353; 61 Am. St. Rep. 436 (where relief was granted in equity to a general manager under an appointment for a term of years); *Dimmick v. Stokes* (Ala.), 43 So. 854 (where the court refused to decree specific performance of a contract by a corporation to employ plaintiff as "general manager").

exclusion from board meetings is alleged; for such a prayer is too general, and the writ, if issued, would be practically impossible to enforce.¹ A director whose associates refuse to permit him to examine the books and papers of the company may compel them to do so by mandamus, and of course it makes no difference that they put their refusal in the form of a by-law, which is clearly void.²

¹ *State ex rel. Rosenfeld v. Einstein*, 46 N. J. Law 479. 118. See also *supra*, § 1101 as to the right of a director to inspect the

² *People v. Throop*, 12 Wend. 511. 118. See also *supra*, § 1101 as to the right of a director to inspect the company's books and papers. As (N. Y.) 183. Cf. *Burn v. London & South Wales Coal Co.*, 7 Times L. R. 118. See also *supra*, § 1101 as to the right of a director to inspect the company's books and papers. As to the remedies for a denial of the right, see § 1112 et seq.

CHAPTER XXVI

LIABILITIES AND DISABILITIES OF DIRECTORS

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§ 1510-§ 1512. *Analogy between Directors and Trustees with respect to the Jurisdiction of Equity over them and their Actions.*

§ 1510. **Jurisdiction over Claims against Director for Misconduct.** — In a former place it has been said that directors may conveniently be viewed in various aspects — as resembling agents, trustees, or managing partners.¹ With respect to their liabilities and disabilities perhaps the most instructive analogy compares them with trustees. True, in some particulars their liability more nearly resembles that of mere agents, but most prominent stands out their position as *quasi* trustees. Thus, from the time of Lord Hardwicke, it has been held that either

¹ *Supra*, § 1399.

wilful or negligent misconduct of a director is so far a breach of trust that a court of equity has jurisdiction of the company's claim for reparation although it be a demand for pecuniary damages.¹ This rule, however, does not apply where a director is also a selling agent, in which capacity and not as director the misbehavior complained of was committed.²

§ 1511. **Jurisdiction of Claim against a Person to whom Directors improperly deliver Funds committed to their Charge.** — Other instances may be given of the close analogy between directors and trustees in respect to the law pertaining to misconduct or breach of trust. Thus, if directors improperly pay out the company's money, a court of equity, on the theory of following trust funds, will entertain a bill by the corporation to compel repayment by the persons by whom the money was received.³ For example, if a director should draw a draft on his company in payment of his

¹ *Charitable Corp. v. Sutton*, 2 Atk. 400, 406; *Fisher v. Parr*, 92 Md. 245; 48 Atl. 621; *Warren v. Para Rubber Co.*, 166 Mass. 97, 104; 44 N. E. 112; *Williams v. McKay*, 40 N. J. Eq. 189, 197; 53 Am. Rep. 775; *Hodges v. New England Screw Co.*, 1 R. I. 312, 340; *Ravenswood, etc. Ry. Co. v. Woodyard*, 46 W. Va. 558 (headnote inadequate); 33 S. E. 285; *Mutual Bldg. Fund v. Bossieux*, 3 Fed. 817; *Mason v. Henry*, 152 N. Y. 529; 46 N. E. 837; *Citizens' Loan Ass'n v. Lyon*, 29 N. J. Eq. 110 (affirmed *sub nomine* *Lyon v. Bower*, 30 N. J. Eq. 340, and *sub nomine* *Lyon v. Citizens' Loan Ass'n*, 30 N. J. Eq. 732); *Cooper v. Hill*, 94 Fed. 582; 36 C. C. A. 402; *Nat. Bank of Commerce v. Wade*, 84 Fed. 10; *Halsey v. Ackerman*, 38 N. J. Eq. 501 (headnote inadequate); *Bosworth v. Allen*, 168 N. Y. 157; 61 N. E. 163; 85 Am. St. Rep. 667; 55 L. R. A. 751; *Consolidated Vinegar Works v. Brew*, 112 Wisc. 610; 88 N. W. 603 (claim for misfeasance as treasurer); *Cockrill v. Cooper*, 86 Fed. 7, 13-16; 29 C. C. A. 529; *Emerson v. Gaither*, 103 Md. 564; *Murphy v. Penniman* (Md.), 66 Atl. 282; *Cushing Sulphite*

Fibre Co. v. Cushing, 2 New Brunsw. Eq. 539, 544-545 (headnote inadequate).

But see *Hun v. Cary*, 82 N. Y. 65, 79; 37 Am. Rep. 546; *Dykman v. Keeney*, 154 N. Y. 483; 48 N. E. 894; *Bay City Bridge Co. v. Van Etten*, 36 Mich. 210. Cf. *North Hudson Bldg., etc. Ass'n v. Childs*, 82 Wisc. 460; 52 N. W. 600; 33 Am. St. Rep. 57.

There is, however, no difference between a director's legal and equitable duties. *Lagunas Nitrate Co. v. Lagunas Syndicate* (1899), 2 Ch. 392, 435.

² *Warren v. Para Rubber Co.*, 166 Mass. 97, 103; 44 N. E. 112; *American Spirits Mfg. Co. v. Easton*, 120 Fed. 440.

³ *Hardy v. Metropolitan Land Co.*, 7 Ch. 427; *Gratz v. Redd*, 4 B. Monr. (Ky.) 178, 194-195; *Hayden v. Thompson*, 36 U. S. App. 361; 71 Fed. 60; 17 C. C. A. 592; *Northwestern Land Ass'n v. Grady*, 137 Ala. 219; 33 So. 874; *Harrison v. Thomas*, 112 Fed. 22; 50 C. C. A. 98; *Hayden v. Brown*, 94 Fed. 15.

But compare *Owen and Ashworth's Claim* (1901), 1 Ch. 115, 121-122.

individual debt, the company may recover from the payee of the draft the amount collected thereon.¹ And consequently, even in England, where no action is ever maintainable on an *ultra vires* contract,² the corporation may recover money which in violation of the Companies Act has been lent on mere personal security³ — for, apart entirely from the contract, the borrower may be held as one into whose hands trust funds have come.⁴ Moreover a court of equity has jurisdiction of a suit by one corporation against another corporation on account of fraudulent transactions by common officers.⁵

§ 1512. **Jurisdiction of Suit for Distribution of Funds in the Hands of Directors.** — If the company's business and undertaking has been sold, so that the company is practically dissolved, a shareholder may, it has been held, maintain a bill on behalf of himself and all other shareholders against the company and the directors to compel the latter to distribute the proceeds of sale among the shareholders;⁶ but in so far as this decision dispenses with the necessity of formal proceedings for the dissolution of the corporation, it seems objectionable, and in conflict with the American cases holding that a court of equity apart from statute has no power to dissolve and wind up a corporation.⁷ This subject is closely akin to the vexed questions in regard to the "trust fund theory" of corporations, which have so perplexed the American courts in cases relating to the dissolution and winding-up of corporations, and is therefore not proper to be considered in detail here.

§ 1513. **Preliminary Statement as to English Cases arising under Section 165 of Companies Act of 1862 and Section 10 of Companies Act of 1893.** — A very large proportion of the English cases on

¹ *Kitchens v. J. H. Teasdale Commission Co.*, 79 S. W. 1177; 105 Mo. App. 463. ⁵ *Candelaria Mining Co. v. Juarez Co.*, 157 Fed. 315.

² See *supra*, § 1027-§ 1031.

³ *Coltman v. Coltman*, 19 Ch. D. 64.

⁴ See also *Ernest v. Croysdill*, 29 L. J. Ch. 580.

⁶ *Cramer v. Bird*, 6 Eq. 143, followed in *Toledo, etc. R. R. Co. v. Continental Trust Co.*, 95 Fed. 497, 531-535; 36 C. C. A. 155.

⁷ E. g. *Barton v. International Fraternal Alliance*, 85 Md. 14; 36 Atl. 658.

directors' liabilities have arisen under § 165 of the Companies Act of 1862.¹ By this section it was enacted that whenever, in the course of the winding-up of any company, it should appear that any director or officer had been guilty of any misfeasance or breach of trust, the court should have power on the application of any creditor or shareholder of the company to compel the misconducting director or officer to make restitution or reparation. This section was repealed (except as to Scotland and Ireland) in 1893,² but was substantially re-enacted by § 10 of the Companies Winding-up Act of that year,³ with an amendment making promoters as well as directors liable to be proceeded against in this summary way. As will be seen, the terms of these enactments are very broad, and have been held to cover all kinds of misconduct of directors, negligence as well as positive misfeasance.⁴

From an American lawyer's point of view, the most important fact is that § 165 of the Act of 1862 — and its substitute, § 10 of the Act of 1890, evidently stands on the same footing — creates no new liability.⁵ It merely provides a summary remedy for wrongs which could otherwise be redressed only by the more tedious procedure of an independent action or suit. Hence, decisions upon directors' liabilities in proceedings under either § 165 of the Act of 1862 or § 10 of the Act of 1893 turn upon general principles of common law and of equity and not upon the terms of a statute; they are therefore of the same authority in the United States as any other English case on a point of common law or general equity. In England, as in America, the liability of a director to the corporation while it is a going concern is the same as in a winding-up.⁶

§ 1514. **When Responsibility and Disabilities of Directors begin.** — A director's disabilities may antedate to some extent his entrance upon office. Thus, it has been held that one whose election to be a director is contemplated by the express terms of a

¹ 25 & 26 Vict., c. 89, § 165.

² 53 & 54 Vict., c. 63, § 33.

³ 53 & 54 Vict., c. 63, § 10.

⁴ *New Mashonaland Co.* (1892),

3 Ch. 577; *Liverpool Household Stores*, 62 L. T. 873, 874.

⁵ *Coventry and Dixon's Case*, 14 Ch. D. 660; *Liverpool Household*

Stores, 62 L. T. 873, 874; *Flitcroft's Case*, 21 Ch. D. 519; *Nant-y-Glo, etc. Ironworks Co. v. Grave*, 12 Ch. D. 738.

Cf. *British Guardian Life Ass. Co.*, 14 Ch. D. 335 (stated *infra*, § 1550 n.).

⁶ *London Trust Co. v. Mackenzie*, 62 L. J. Ch. 870, 876.

contract between him and the company is affected with the same disabilities in respect to making that contract as if he had been actually in office at the time.¹ *A fortiori*, one who resigns as director and is shortly thereafter re-elected will be treated as if he had been a director all along, in respect to contracts entered into with the company during the interval.² A director's responsibility for misconduct of the board may in some cases begin at once upon his election;³ but on the other hand he may sometimes be allowed a brief period after election in which to orient himself before being held responsible for the actions of the board.⁴

§ 1515. **When Responsibility and Disabilities of Directors end.**—As soon as a director's resignation has taken effect, or his term of office otherwise terminated, his responsibility for subsequent actions of the board ceases;⁵ and his relation to the company becomes that of any private member. The case is not altered because the ex-director's name appears with his knowledge on the list of directors, so that the shareholders still believe him to be a member of the board.⁶ Nevertheless, to some extent, the disabilities of the office cling to him.⁷ For instance,

¹ *Hubbard v. New York, etc. Investment Co.*, 14 Fed. 675. But see *Brooklyn Heights Realty Co. v. Kurtz*, 115 N. Y. App. Div. 74.

² *Millsaps v. Chapman*, 76 Miss. 942; 26 So. 369; 71 Am. St. Rep. 547.

³ *Rankin v. Cooper*, 149 Fed. 1010, 1018 (*Abeles's Case*).

⁴ *Rankin v. Cooper*, 149 Fed. 1010, 1019 (where defendant Joyce was allowed 30 days for this purpose).

⁵ *Briggs v. Spaulding*, 141 U. S. 132, 152-154; 11 Sup. Ct. 924; *Sinclair v. Dwight*, 9 N. Y. App. Div. 297, 303; 41 N. Y. Supp. 193; *Chemical Nat. Bank v. Colwell*, 132 N. Y. 250; 30 N. E. 644; *Hoboken Beef Co. v. Hand*, 104 N. Y. App. Div. 390; 93 N. Y. Supp. 834 (where the defendant had ceased to be a director before the expiration of the period allowed by law for the filing of certain reports); *Squires v. Brown*, 22 How. Pr. (N. Y.) 35.

But cf. *Bosworth v. Allen*, 168 N. Y. 157; 61 N. E. 163; 85 Am.

St. Rep. 667; 55 L. R. A. 751 (where the resignation was for the purpose of transferring control of the company to members of a fraudulent conspiracy); *Osborn v. Gilliam*, 33 N. Y. Misc. 312; 68 N. Y. Supp. 470 (where an officer was held liable to a statutory penalty for failing to furnish certain information in regard to the company, although he had resigned after the demand and before the time allowed by the statute for compliance).

⁶ *National Bank of Wales* (1899), 2 Ch. 629 (affirmed *sub nomine* *Dovey v. Cory* (1901), A. C. 477).

⁷ Cf. *Nixon v. Goodwin* (Cal.), 85 Pac. 169 (holding that a director who resigns in order to qualify himself to take a conveyance of property from the corporation is subject as to that conveyance to the same disabilities as if he had continued to be a director). As to the limits of the principle stated in the text, see *Stanton v. Gilpin*, 38 Wash. 191; 80

he would not be allowed to profit at the expense of the company by knowledge acquired while a member of the board.¹ Neither will he be permitted to recover against the company on debentures which he bought up at a discount after resignation but which while director he ought to have avoided because of fraud in their issue.² So, where directors after severing their connection with the corporation buy in a patent which the company has been infringing, neither they nor their assignee will be allowed to recover from the company the profits created by their own acts of infringement.³

§ 1516-§ 1562. *LIABILITIES OF DIRECTORS TO THE CORPORATION IN DAMAGES.*

§ 1516. **Misconduct of Directors without resulting Damage to Company not actionable.** — Although directors may have been guilty of negligence or breach of trust, yet they are not liable to any civil action or proceeding unless their misconduct has resulted in loss to the company.⁴ But where the directors have made profits or received bribes which belong to the company in equity, the failure to pay over such profits or bribes is a loss to the corporation within the meaning of the doctrine just laid down.⁵ Moreover, where the directors have fraudulently issued promissory notes of the company, they are liable for the amount of the notes without proof of payment by the corporation if the notes have passed into the hands of a *bona fide* holder for value.⁶ It has been held in Ireland that where the liquidator of a corporation in a proceeding against the directors for mis-

¹ *Vulcan Detinning Co. v. Am. Can Co.* (N. J.), 67 Atl. 339. Md. 564, 581-582 (headnote inadequate).

Cf. *New York Automobile Co. v. Franklin*, 49 N. Y. Misc. 8, 13-14; 97 N. Y. Supp. 781. Cf. *Bentinck v. Fenn*, 12 A. C. 652; *Keeney v. Converse*, 99 Mich. 316; 58 N. W. 325; *Reno Oil Co. v. Culver*, 60 N. Y. App. Div. 129; 69 N. Y. Supp. 969.

² *Ex parte Larking*, 4 Ch. D. 566.

³ *New York Grape Sugar Co. v. Buffalo Grape Sugar Co.*, 24 Fed. 604.

⁴ *Liverpool Household Stores*, 62 L. T. 873, 876-877; *New Mashonaland Co.* (1892), 3 Ch. 577; *Wallace v. Lincoln Savings Bank*, 89 Tenn. 630, 647; 15 S. W. 448; 24 Am. St. Rep. 625; *Emerson v. Gaither*, 103

Archer's Case (1892), 1 Ch. 322. As to accountability of directors to the company for profits, see *infra*, § 1607-§ 1631.

⁶ *Metropolitan, etc. Ry. Co. v. Kneeland*, 120 N. Y. 134; 24 N. E. 381; 17 Am. St. Rep. 619; 8 L. R. A. 253.

feasance succeeds in establishing that the defendants have been guilty of misconduct but fails in proving any pecuniary damage to the company, the guilty directors should nevertheless be required to pay the costs.¹

§ 1517-§ 1524. LIABILITY OF DIRECTORS FOR ULTRA VIRES ACTS.

§ 1517. **In general.** — From early days a broad distinction has been drawn between the responsibilities of directors when acting *ultra vires* and *intra vires*. In the case of *intra vires* actions, a very strong case of fraud or negligence must be established in order to hold the directors liable; but whenever they intentionally do that which is *ultra vires*, they commit a breach of trust and are always liable to the corporation for all losses which it may sustain in consequence.²

§ 1518. **Acts beyond the Powers of the Directors but not Ultra Vires of the Corporation.** — In this connection the distinction is between matters *ultra vires* of the directors and those within their powers, and not between matters *ultra vires* and *intra vires* of the corporation as a whole. That is, directors are responsible for acts which are beyond their own powers but *intra vires* of the corporation to the same extent as if such actions were also *ultra vires* of the company.³ Whenever they intentionally transcend their own powers, liability for all resulting damages to the corporation attaches. As to this matter, the only difference between acts within and without the powers of the corporation is that in the former case the actions of the directors may be authorized or ratified by a majority of the shareholders, while in the latter case such authority or ratification affords no protection to the directors.

§ 1519. **Miscellaneous Cases of Liability for Ultra Vires Acts.** — The cases in which directors have transcended their powers,

¹ *David Ireland & Co.* (1905), 1 Ir. 133.

² *Charitable Corporation v. Sutton*, 2 Atk. 400, 405; *Cullerne v. London, etc. Bldg. Soc.*, 25 Q. B. D. 485, 487, 490; *Leeds Estate, etc. Co. v. Shepherd*, 36 Ch. D. 787; *Williams v. McDonald*, 42 N. J. Eq. 392; 7 Atl. 866.

³ *Liverpool Household Stores*, 62 L. T. 873, 875; *Citizens Bldg., etc. Ass'n v. Coriell*, 34 N. J. Eq. 383; *Oakland Bank v. Wilcox*, 60 Cal. 126 (violations of by-law by officers); *British Guardian Life Ass. Co.*, 14 Ch. D. 335.

But see *Godbold v. Branch Bank*, 11 Ala. 191; 46 Am. Dec. 211.

and have consequently incurred liability to the company, are as diverse as the possible modes of exceeding their authority. The nature and extent of their liability, however, is not in any way affected by the particular kind of *ultra vires* acts in which they have engaged. If for any *ultra vires* purpose they have paid out funds of the corporation, they are bound to replace them.¹ For instance, if they pay dividends when profits available for that object have not been earned, they must repay to the company the full amount thus paid out.² So, if they without authority return capital to the shareholders, they must make good the loss to the corporation.³ If they allot shares to an infant, they are responsible for the calls thereon.⁴ If they issue accommodation paper, they must reimburse the company for its liability thereon.⁵ If they invest the company's funds in any unauthorized securities, — for example, in the company's own shares⁶ or in shares of another corporation,⁷ — they are liable to their company for the sums so expended. In the same way they are responsible for any payment for a purpose unconnected with the company's business. If they pay money as salary to an officer who is not entitled thereto, they must make it good to the company.⁸ So, if without legal warrant they accept promissory notes in payment of subscriptions to shares of the capital in lieu of cash, they will be liable for the amount thus lost by the company.⁹

Where directors issue shares at less than par, they are liable to the company for the amount of the discount, if such issue be

¹ See *Cooper v. Hill*, 94 Fed. grounds, 65 N. J. Eq. 372; 54 Atl. 582; 36 C. C. A. 402; *Gilbert* 405, 1125.

v. *Finch*, 173 N. Y. 455, 460; 66 N. E. 133; 93 Am. St. Rep. 623; 61 L. R. A. 807; and cases cited below.

² *Leeds Estate, etc. Co. v. Shepherd*, 36 Ch. D. 787; *Flitcroft's Case*, 21 Ch. D. 519; *National Funds Ass. Co.*, 10 Ch. D. 118; *Rance's Case*, 6 Ch. 104; *Salisbury v. Metropolitan Ry. Co.*, 22 L. T. 839; *Municipal Freehold Land Co. v. Pollington*, 63 L. T. 238.

But see *Siegman v. Malony*, 63 N. J. Eq. 422, 51 Atl. 1003 (holding directors not liable unless company insolvent), affirmed on other

³ *Moxham v. Grant* (1900), 1 Q. B. 88.

⁴ *Ex parte Wilson*, 8 Ch. 45.

⁵ *Hutchinson v. Sutton Mfg. Co.*, 57 Fed. 998.

⁶ *Marzetti's Case*, 28 W. R. 541.

⁷ *Lands Allotment Co.* (1894), 1 Ch. 616.

Cf. Joint Stock Discount Co. v. Brown, 3 Eq. 139, 8 Eq. 381.

⁸ *Ellis v. Ward*, 137 Ill. 509; 25 N. E. 530.

⁹ *Moses v. Ocoee Bank*, 1 Lea (Tenn.) 398, 405-406 (semble); *Cockrill v. Abeles*, 86 Fed. 505; 30 C. C. A. 223.

forbidden by law, even though the price at which the shares were issued was greater than their market value at the time of the agreement.¹ If at that time the shares were worth in a steady market more than par, the directors would doubtless be liable for the full difference between such market-price and the price of issue.

§ 1520. **Illegal or immoral Actions — Acts prohibited by Statute.** — Directors are likewise personally liable to the company for payments made for any improper or illegal purpose² — for example, for “bulling” the company’s shares or “rigging the market,”³ or for “lobbying” for a legislative appropriation in the company’s favor.⁴ But it has been held that a statute imposing a fine upon a director who borrows money from his company does not make the co-directors who lend him the money liable for loss sustained by the company from the loan;⁵ but this decision not merely involves the doubtful proposition that such a loan is proper unless prohibited by statute, but also tends to defeat the policy of the statute in question.

§ 1521. **Whether Liability for Acts prohibited by Statute arises from the Statute or from the Common Law.** — The liability of directors for engaging in *ultra vires* transactions may be deemed to arise from the common law even where the transaction in question is *ultra vires* only because prohibited by statute.⁶ Hence, in such a case, where a statute prohibits the making of loans to any one person in excess of one tenth of the company’s capital and provides that upon forfeiture of the company’s charter the directors may be held liable for so doing, the company may recover damages from the directors for making such loans even though the charter has not been forfeited.⁷ In such a case, however, if the statute which prohibits the loans is a federal statute, the case is deemed to arise under the laws of the

¹ *Hirsche v. Sims* (1894), A. C. 654, stated more fully infra, § 1524.

² Cf. *Bowers v. Male*, 186 N. Y. 28 (headnote inadequate).

³ *Imperial Mercantile Credit Co.*, 5 Eq. 264; *Marzetti’s Case*, 42 L. T. 206.

⁴ *Shea v. Mabry*, 1 Lea (Tenn.) 319, 340-341 (headnote inadequate).

⁵ *Wheeler v. Aiken, etc. Bank*, 75 Fed. 781.

⁶ Cf. *Lexington, etc. R. R. Co. v. Bridges*, 7 B. Monr. 556, 560-561; 46 Am. Dec. 528.

⁷ *Cockrill v. Cooper*, 86 Fed. 7; 29 C. C. A. 529; *Nat. Bank of Commerce v. Wade*, 84 Fed. 10 (where the right of the government to forfeit the charter had been barred by limitations).

United States so as to give a federal court jurisdiction of the suit independently of any diversity of citizenship.¹

§ 1522. **Ultra Vires Non-feasance — Failure to perform explicit Duty.** — Generally, mere *non-feasance* on the part of the directors is at most negligence, and cannot fall within the category of *ultra vires* matters. But where by statute or a company's regulations directors are under a positive duty to act in any prescribed manner, their failure to do so subjects them to the same liabilities as if they had overstepped their powers. For instance, where the mode of keeping or examining accounts is prescribed, directors are responsible for failing to have them kept or examined in that manner.² So, where directors are commanded by the corporation to invest in certain specified securities, they are clearly liable for failing to do so.³ Likewise, if by-laws require the directors to hold weekly meetings, they are responsible for any loss occasioned by their omission so to do.⁴

§ 1523-§ 1524. *Bona Fides of Directors as Defence to Liability for Ultra Vires Acts.*

§ 1523. **In general.** — Where directors intentionally do what is beyond their powers, it is no defence that they acted without negligence and with a *bona fide* desire to advance the interests of the company.⁵ Nor is it any defence, according to the better view, that they may have honestly misconstrued their powers, and consequently believed that what they were doing was *intra vires*.⁶ On the other hand, the liability does not attach unless

¹ *National Bank of Commerce v. Wade*, 84 Fed. 10. 322). Cf. *Williams v. McDonald*, 42 N. J. Eq. 392; 7 Atl. 866.

² *Leeds Estate, etc. Co. v. Shepherd*, 36 Ch. D. 787; *Campbell v. Watson*, 62 N. J. Eq. 396, 415-416; 50 Atl. 120.

³ *British Guardian Co.*, 14 Ch. D. 335.

⁴ *Marshall v. Savings Bank*, 85 Va. 676 (headnote inadequate); 8 S. E. 586; 17 Am. St. Rep. 84; 2 L. R. A. 534.

⁵ *Cullerne v. London, etc. Bldg. Soc.*, 25 Q. B. D. 485, 490 (overruling *Pickering v. Stephenson*, 14 Eq.

A company's "complaints," said the United States Supreme Court, "that its own directors exceeded their authority come with ill grace when the acts complained of alone preserve its existence." *Pneumatic Gas Co. v. Berry*, 113 U. S. 322, 327; 5 Sup. Ct. 525. In such a case, it may be said in passing, the directors would incur no liability because the company could prove no damage. *Supra*, § 1516.

⁶ *Liverpool Household Stores*, 62

they intentionally do what is in fact beyond their powers. For instance, the payment of dividends out of capital is *ultra vires*, and if directors knowingly consent thereto they would be responsible, although they may have believed such payment to be authorized by law. But if they honestly but mistakenly believe that profits available for dividends have been earned, they cannot be held responsible in the absence of negligence if it should afterwards appear that in fact the payments were made out of capital.¹ In other words, a mistake of law as to the extent of their powers will not afford protection; but an honest and reasonable though mistaken belief in the existence of facts which would render their action rightful will be a sufficient excuse.² When, however, it is shown that in point of fact the acts of directors have been *ultra vires*, the burden of excusing themselves by establishing a reasonable belief in facts which would have made them *intra vires* rests upon the directors.³

§ 1524. **As to the Measure of Damages.**—In some cases,

L. T. 873, 875; *National Funds Ass. Co.*, 10 Ch. D. 118, 128 (headnote inadequate); *Brinkerhoff Zinc Co. v. Boyd*, 192 Mo. 597; 91 S. W. 523 (where the corporation maintained a bill to annul the transaction but did not attempt to hold the directors liable for damages).

But see contra: *Hodges v. New England Screw Co.*, 1 R. I. 312; *Spering's Appeal*, 71 Pa. St. 11, 24-25 (headnote inadequate); 10 Am. Rep. 684; *Watt's Appeal*, 78 Pa. St. 370.

Cf. *Scott v. Depeyster*, 1 Edw. Ch. (N. Y.) 513, 533-534. Now, by statute, it is provided in England that when it appears that a director is liable for "negligence or breach of trust," the court may relieve him from liability, either absolutely or conditionally, if the evidence shows that he "has acted honestly and reasonably and ought fairly to be excused." Stat. 7 Edw. VII, c. 50 (Companies Act, 1907), § 32. It will be interesting to see what the English courts make of this novel power of judicial pardon.

¹ *Leeds Estate Co. v. Shepherd*, 36 Ch. D. 787; *Dovey v. Cory* (1901), A. C. 477; *Davenport v. Lines*, 77 Conn. 473; 59 Atl. 603.

Cf. *Gaffney v. Colvill*, 6 Hill (N. Y.) 567, 575 (as to a statutory liability); *Ebelhar v. German Am. Sec. Co. (Ky.)*, 91 S. W. 262.

² Cf. *London Trust Co. v. Mackenzie*, 62 L. J. Ch. 870, 876. As to the distinction stated in the text, see *National Funds Ass. Co.*, 10 Ch. D. 118, 128, where Sir George Jessel said, "when a man" — *i. e.*, a director — "misappropriates money with a knowledge of all the facts, I cannot allow him to say that he is not liable because somebody or other told him that he was not doing wrong, or that somehow or other he convinced himself that he was not doing wrong."

³ *Leeds Estate, etc. Co. v. Shepherd*, 36 Ch. D. 787; *Lucas v. Fitzgerald*, 20 Times L. R. 16 (ruling as to the defendant Norman); *Gaffney v. Colvill*, 6 Hill (N. Y.) 567, 576.

But see *Davenport v. Lines*, 77 Conn. 473; 59 Atl. 603.

even of *ultra vires* actions intentionally done, the *bona fides* of directors may avail them to a limited extent. That is, the courts will naturally look with scant favor on directors who were guilty of known wrongdoing, and will sometimes indulge presumptions against them as to the measure of damages and the like, although, had their course been morally innocent, such presumptions would not be raised. For example, in a case in the Privy Council, the directors of a South African mining company, acting illegally but nevertheless, as they honestly believed, for the best interests of the corporation, gave the company's engineer an option of taking ten thousand shares at ninety per cent of their par value. When this option was given, the shares were selling below ninety: when it was exercised, and the shares actually issued, they were quoted above par, and they subsequently rose even higher. It was held that since the directors had acted throughout in good faith, the measure of the company's damages against them would be the difference between the price obtained for the shares and their par value, although if their actions had been characterized by *mala fides* they would have been liable in addition for the amount of the premium at which the company's shares were selling at the time the shares in question were actually issued.¹

§ 1525-§ 1530. *Liability of Directors for Fraud.*

§ 1525. **In general.** — It is scarcely necessary to say that in any case of fraudulent design on the part of directors to injure their company, whether their outward acts be *ultra vires* or *intra vires*, they will certainly be held liable for all resulting loss to the corporation.² Such flagrant breach of trust, however, is very difficult to prove, and the decided cases are comparatively rare in which the charge has been substantiated. The cases in which the charge is made generally turn on questions of fact. If a breach of trust of this character be consummated by confederation with one who does not stand in a fiduciary relation to the company, he will be liable to the company in an

¹ *Hirsche v. Sims* (1894), A.C. 654. *holtz*, 45 Kans. 164; 25 Pac. 613

² See *Miner v. Belle Isle Ice Co.*, (where the directors issued to themselves at par stock which they might have sold to the public at a much larger price).

Cf. *Arkansas, etc. Society v. Eich-*

action of tort for damages, jointly and severally with the misbehaving directors.¹

§ 1526. **Effect of Failure of Company to rescind the fraudulent Transaction.** — Of course, the fact that the company has omitted to rescind the fraudulent transaction (as by timely action might have been done) is no bar to a suit for damages against the fraudulent directors. For example, a claim for damages against directors for fraudulently issuing shares to a person who was not entitled to them is not barred by laches because the company takes no action until the shares have come into the hands of a *bona fide* purchaser and until rescission of the issue has thus been made impossible.²

§ 1527. **Whether Acts done for a Purpose other than Furtherance of the Welfare of the Company are necessarily fraudulent in Law.** — Ordinarily, any action which directors take for any other purpose than to promote their company's prosperity is deemed fraudulent in law.³ But they are bound to act for the interest of the company only when so to do does not involve any moral obliquity on their part. They are not required to act dishonestly in the interest of their company, or even to run counter to scruples that are, perhaps, over-conscientious. Thus, a director is not liable for warning persons who are about to enter into a contract with the company that its condition is financially unsound.⁴ Neither are directors under any obligation to surrender any of their own personal rights in order to advantage the corporation. Thus, they cannot be liable for declining to accept on behalf of the corporation a proposal, however beneficial to the company, which involves a stipulation that they shall resign their directorship.⁵

§ 1528. **Whether Acts really believed to be for the best Interests of the Company can ever be fraudulent.** — Some acts which are

¹ See *Boston v. Simmons*, 150 Mass. 461; 23 N. E. 210; 6 L. R. A. 629; 15 Am. St. Rep. 230. While this case relates to an officer of a municipal corporation and not to a director of a private company, that circumstance is believed to be immaterial so far as this point is concerned. See also *Emery v. Parrott*, 107 Mass. 95, 99, and *infra*, § 1651. As to the liability of a third

person for profits made by confederating with a director, see *infra*, § 1610.

² *Brooklyn, etc. R. R. Co. v. Strong*, 75 N. Y. 591.

³ *Madden v. Dimond*, 12 Brit. Columb. 80.

⁴ *Hale v. Mason*, 160 N. Y. 561; 55 N. E. 202.

⁵ *Bayles v. Vanderveer*, 11 N. Y. Misc. 207; 32 N. Y. Supp. 1117.

within the powers of the directors and which they honestly believe will subserve the best interests of the company may perhaps be deemed fraudulent. For instance, to issue shares in the company's treasury for the purpose of maintaining themselves in control of the corporation, when a better price could be realized from other persons, may be deemed fraudulent on the part of directors even if they honestly believe that the success of the opposite faction would be disastrous to the company.¹ Perhaps however, cases of this sort can be explained upon the ground that acts done for the purpose of participating in factional disputes among the shareholders are *ultra vires*² rather than upon the ground that such acts are fraudulent.

§ 1529. **Constructive Fraud — Participation by Directors in Transactions in which they have an individual Interest adverse to the Company.** — As will presently be explained, directors ought not, on behalf of the company, to enter into transactions in which they or some of them have an individual interest, and consequently if they do so they are committing a wrong. As will also be more fully explained below, the company may in any such case rescind the objectionable transaction, or may affirm it and require the interested directors to account to the corporation for their profits. Generally, one or the other of these remedies is ample; but in rare cases neither is quite adequate. Under those exceptional circumstances the company, it would seem, may hold the directors responsible for all losses which it has sustained by reason of their breach of duty. To be sure, in some cases the courts seem to have denied that directors are liable to the company in damages for entering into contracts in which they have a private interest, unless they were guilty of actual fraud, and not merely of the "constructive fraud" of placing themselves in a situation where their duties and interests conflict;³ but this seems to be an illogical view. If they do wrong, they ought to be liable in damages. For instance, if directors should sell the company's property to themselves at less than

¹ *Elliott v. Baker* (Mass.), 80 N. Supp. 263 (holding that a director is not liable in damages for "constructive fraud" for purchasing for the company property of a co-director at a valuation which is un-

² See *supra*, § 95-§ 97.

³ Cf. *Eooth v. Robinson*, 55 Md. 419, 442; *Godfrey v. McConnell*, 151 Fed. 783; *Polhemus v. Polhemus*, 114 N. Y. App. Div. 781; 100 N. Y. intentionally excessive).

its value, the corporation might rescind the transaction and, returning the purchase-money, reclaim the property, or it might affirm the transaction and require the directors to account for the profits that they may have made thereby, — for example, on a resale, — or finally it might sue the directors for damages, and recover the difference between the price which they paid and that which the company might have received from another purchaser.¹

Upon this same principle, where a director attempts to renew in his own name a lease held by the corporation, the new lease to contain a condition against assignment, and by means of this attempt forces the company to agree to pay a higher rental to the lessor in order to retain possession of the demised premises, the director is liable to the company for its damages.²

§ 1530. **Fraud committed as Agent for a Person who is Dealing with the Corporation.** — In one case it was held that a director who as agent for his father makes certain false representations to his fellow directors, in order to induce the company to violate its charter by discounting certain notes belonging to the father, is not guilty of a breach of duty as director.³ This decision seems to proceed upon the theory that a director may lay aside his trusteeship at will and act in hostility to his company — a theory which it would be very difficult to support by any sound view of the relationship and duties of a director.

§ 1531-§ 1547. LIABILITY OF DIRECTORS FOR NEGLIGENCE.

§ 1531. **In general.** — Where directors act honestly and within their powers, they are not generally liable for their actions — even for actions which are attended with disastrous consequences to the company. Yet they must not supinely permit the corporation to drift to rack and ruin, nor may they with impunity plunge it into wild schemes necessarily resulting in

¹ *Manufacturers, etc. Bank v. he permitted to be contracted by Big Muddy Iron Co.*, 97 Mo. 38; 10 a firm in which his sons were interested. S. W. 865 (semble).

Cf. *Greenfield Savings Bank v. ² Acker, Merrall & Condit Co. Simons*, 133 Mass. 415. In *Doe v. v. McGaw (Md.)*, 68 Atl. 17.

Northwestern, etc. Co., 78 Fed. 62, ³ *Hicks v. Steel*, 105 N. W. 767; 70-71, a director was held responsible for a debt to the company which 142 Mich. 292.

disaster. To borrow a phrase from Sir Edward Coke's Reports, "Governors ought not to be idle as Cyphers in Algebra."¹ "By accepting a trust of this sort, a person is obliged to execute it with fidelity and reasonable diligence; and it is no excuse to say that they had no benefit from it, but that it was purely *honorary*."² Thus, they may be liable for permitting notes held by the company to become barred by limitations.³

§ 1532. **What Risks Directors may properly incur — Distinction between Directors and ordinary Trustees — Effect of Nature of the Company's Business.** — Although directors are often called trustees, yet their position is wholly different from that of ordinary trustees under a will or settlement. For the very object of the usual business corporation is to adventure its capital. Risks, therefore, which no ordinary trustee would be permitted to take are quite proper for directors.⁴ Doubtless, in determining whether directors have come up to the standard of care and diligence which the law requires of them, some consideration should be given to the nature of the company's business. Thus, a corporation formed for the purpose of speculation, or for the development of a patent of problematical value, or the like, might properly incur risks that a savings bank, for instance, should never run.⁵ Indeed, where a corporation is formed for the express purpose of engaging in a hazardous business, the directors are not responsible for doing so, no matter how imprudent such action may be. Thus, where a corporation was organized for the express purpose of purchasing a risky and indeed insolvent business of a firm of bill-brokers, the directors are not liable for consummating the purchase.⁶ The degree of care required depends upon the subject to which it is to be applied, and in each case the question is largely one of fact, to be

¹ *Sutton's Hospital Case*, 10 Co. 1, 23.

² *Charitable Corporation v. Sutton*, 2 Atk. 400, 406 (per Lord Hardwicke); *Williams v. McKay*, 40 N. J. Eq. 189, 195; 53 Am. Rep. 775.

Cf. *Prefontaine v. Grenier* (1907), A. C. 101, 110. As to a curious statutory power of the English courts to excuse directors from liability for negligence when they have acted "honestly and reasonably," see *supra*, § 1523 n.

³ *Moses v. Ocoee Bank*, 1 Lea (Tenn.) 398, 405-406 (semble).

But cf. *Wallace v. Lincoln Savings Bank*, 89 Tenn. 630; 15 S. W. 448; 24 Am. St. Rep. 625.

⁴ In addition to cases cited below, see *Cushing Sulphite Fibre Co. v. Cushing*, 2 New Brunsw. Eq. 539, 554-557 (headnote inadequate).

⁵ *Hun v. Cary*, 82 N. Y. 65, 71; 37 Am. Rep. 546.

⁶ *Overend & Gurney Co. v. Gibb*, L. R. 5 H. L. 480.

determined in view of all the circumstances.¹ Much, also, will depend upon the custom of the community in which the business is done; for directors cannot be held to any more rigorous standard than that set by the business methods prevalent in similar companies in their neighborhood.²

§ 1533. **Mere Errors of Judgment — Necessity for proving "Gross Negligence."** — The rule is that for any mere error of judgment directors are not ordinarily liable.³ Their negligence, it is said, in order to give the company a cause of action against them, must be "crass" or "gross."⁴ However much these adjectives may be inveighed against as mere "vituperative epithets," they are intended to express this truth, that directors are not liable for mere negligence unless it be such as to amount, practically, to failure to exercise their own discretion.⁵ Whether the term "gross negligence" be adopted or rejected is a mere matter of taste; the authorities are in substantial agreement as to the degree of care which the office demands. It is not enough to make directors liable that their actions were a "grave error of judgment."⁶

§ 1534. **Mistakes of Law.** — It makes no difference that the error of judgment complained of was a mistake of law. Directors are not responsible for honestly and without negligence misapprehending the law. Thus, where by-laws require direc-

¹ *Briggs v. Spaulding*, 141 U. S. 132; 11 Sup. Ct. 924.

² *Wheeler v. Aiken, etc. Bank*, 75 Fed. 781.

Cf. *Campbell v. Watson*, 62 N. J. Eq. 396; 50 Atl. 120.

³ *Spering's Appeal*, 71 Pa. St. 11; 10 Am. Rep. 684; *Smith v. Prattville Mfg. Co.*, 29 Ala. 503; *Citizens, etc. Bldg. Ass'n v. Coriell*, 34 N. J. Eq. 383; *Booth v. Robinson*, 55 Md. 419; *Campbell v. Watson*, 62 N. J. Eq. 396, 409; 50 Atl. 120; *Coddington v. Canaday*, 157 Ind. 243, 260; 61 N. E. 567 (semble).

See also *Wallace v. Lincoln Savings Bank*, 89 Tenn. 630; 15 S. W. 448; 24 Am. St. Rep. 625 (where directors were held not liable for permitting debts due to the company to become outlawed and for failing to enforce claims alleged to be usurious).

⁴ *Overend & Gurney Co. v. Gibb*, L. R. 5 H. L. 480 (especially Lord Hatherley's judgment); *Liverpool Household Stores*, 62 L. T. 873, 874; *Percy v. Millaudon*, 8 Martin, n. s. (La.), 68; 3 La. 568; *Swentzel v. Penn Bank*, 147 Pa. St. 140; 23 Atl. 405, 415; 30 Am. St. Rep. 718; 15 L. R. A. 305; *Killen v. Barnes*, 106 Wise. 546, 574-575; 82 N. W. 536; *Citizens Bldg., etc. Ass'n v. Coriell*, 34 N. J. Eq. 383; *Jones v. Johnson*, 86 Ky. 530; 6 S. W. 582; *Booth v. Robinson*, 55 Md. 419; *David Reus, etc. Co. v. Conrad*, 101 Md. 224, 228-229 (headnote inadequate); 60 Atl. 737.

⁵ *New Mashonaland Co.* (1892), 3 Ch. 577.

⁶ *Faure Electric Accumulator Co.*, 40 Ch. D. 141.

tors to take bond from the company's secretary for the faithful performance of his duties, they are not responsible for acting under the mistaken belief that a bond given for one term would operate in law to cover a period of office for which he was re-elected.¹ The only exception to this principle that directors are no more responsible for mistakes of law than for mistakes of fact (if, indeed, there be any exception) lies in cases where the mistake relates to the extent of their own powers or those of the corporation.²

§ 1535. **Failure to consult Shareholders about perplexing Questions.** — Directors cannot be held liable for a mistake in judgment although when in perplexity they failed to convene and consult the shareholders; for if a shareholders' meeting had been called, one cannot say that the same course of action which was taken by the directors would not have been resolved upon.³

§ 1536. **American Cases tending toward holding Directors to a higher Degree of Care.** — While the principles stated above as to the standard of care required of directors are probably supported by the weight of authority on both sides of the Atlantic, yet a tendency is exhibited in some American cases to hold directors to a greater nominal degree of care. These cases repudiate the view that directors acting *intra vires* are liable only for gross negligence, and lay down the rule that they are bound to exercise the same degree of care ordinarily exercised by men of common prudence in their own affairs.⁴ According to these authorities, a director may be liable for an error in judgment if it was due to a failure to possess that amount of discretion and business sense which every such official ought to have. The discrepancy between these decisions and those of the English courts is probably more apparent than real. Upon the same state of facts, the same conclusion would probably be reached everywhere. Thus, gross negligence in this connection has been defined as "an absence of that diligence that ordinarily prudent men in the conduct of such business would have exercised."⁵

¹ *Vance v. Phœnix Ins. Co.*, 4 R. R. Co., 43 N. H. 515, 529 (semble); *Lea* (Tenn.) 385.

² *Supra*, § 1523.

³ *Lagunas Nitrate Co. v. Lagunas Syndicate* (1899), 2 Ch. 392, 437.

⁴ *Hun v. Cary*, 82 N. Y. 65; 37 Am. Rep. 546; *March v. Eastern*

R. R. Co., 43 N. H. 515, 529 (semble); *Shea v. Mabry*, 1 Lea (Tenn.) 319; *Warren v. Robinson*, 19 Utah 289; 57 Pac. 287; 75 Am. St. Rep. 734; *Scott v. Depeyster*, 1 Edw. Ch. (N. Y.) 513 (semble).

⁵ *Savings Bank of Louisville's*

§ 1537. **Age and Illness as extenuating Circumstances.** — In determining whether a director has been guilty of negligent inattention to duty, age and illness may be reckoned as extenuating circumstances.¹ On the other hand, if a director should find himself permanently incapacitated from performing the duties of his office, he should resign; and if he continues to hold the position, cannot escape its responsibilities on the ground of the incapacity of age or illness.²

§ 1538. **Extent of Knowledge wherewith Directors are chargeable.** — In determining whether or not directors have discharged their legal duty of care and watchfulness, it is important to inquire with how great a knowledge of the company's affairs they are chargeable. Clearly they cannot be charged with constructive notice of the contents of the company's books;³ but on the other hand they must be taken to have known the corporation's charter, incorporation paper and by-laws,⁴ and generally everything about its affairs that by due diligence and attention to duty they ought to have known.⁵ It has even been

Assignee v. Caperton, 87 Ky. 306, 313-314; 8 S. W. 885; 12 Am. St. Rep. 488.

See also *Dunn's Adm'r v. Kyle*, 14 Bush. (Ky.) 134.

¹ *Briggs v. Spaulding*, 141 U. S. 132; 11 Sup. Ct. 924.

² *Rankin v. Cooper*, 149 Fed. 1010, 1016.

³ *Hallmark's Case*, 9 Ch. D. 329; *Denham & Co.*, 25 Ch. D. 752, 766; *Briggs v. Spaulding*, 141 U. S. 132, 162-163; 11 Sup. Ct. 924; *Wallace v. Savings Bank*, 89 Tenn. 630, 659; 15 S. W. 448; 24 Am. St. Rep. 625; *Rudd v. Robinson*, 126 N. Y. 113; 26 N. E. 1046; 22 Am. St. Rep. 816; 12 L. R. A. 473; *Mason v. Moore*, 73 Oh. St. 275; 76 N. E. 932.

But see *Ex parte Brown*, 19 Beav. 97 (overruled), approved in *Greenville Gas Co. v. Reis*, 54 Oh. St. 549, 558; 44 N. E. 271; *Hall v. Henderson*, 126 Ala. 449, 490-496; 28 So. 531; 85 Am. St. Rep. 53; 61 L. R. A. 621; *Finn v. Brown*, 142 U. S. 56; 12 Sup. Ct. 136 (director charged with notice that he was reg-

istered as a shareholder); *First Nat. Bank v. Tisdale*, 18 Hun (N. Y.) 151; *Pacific Vinegar, etc. Co. v. Smith* (Cal.), 93 Pac. 85, 87 (semble).

⁴ Cf. *Hunter v. Sun Mutual Ins. Co.*, 26 La. Ann. 13; *Douglass v. Merchants' Ins. Co.*, 118 N. Y. 484; 23 N. E. 806; 7 L. R. A. 822; *Selley v. American Lubricator Co.*, 93 N. W. 590; 119 Iowa 591.

⁵ *Ex parte Larking*, 4 Ch. D. 566; *Union Nat. Bank v. Hill*, 148 Mo. 380; 49 S. W. 1012; 71 Am. St. Rep. 615; *Corbett v. Woodward*, 5 Sawy. 403; *College Park Electric Belt Line v. Ide & Son*, 15 Tex. Civ. App. 273; 40 S. W. 64; *Hall v. Henderson*, 126 Ala. 449, 490-496; 28 So. 531; 85 Am. St. Rep. 53; 61 L. R. A. 621.

Cf. *James Clark Co. v. Colton*, 91 Md. 195; 46 Atl. 386; 49 L. R. A. 698; *Williams v. McKay*, 40 N. J. Eq. 189; 53 Am. Rep. 775; *Jones v. Arkansas Mech., etc. Co.*, 38 Ark. 17; *Baines v. Coos Bay, etc. Nav. Co.*, 77 Pac. 400; 45 Oreg. 307; *Frellsen v. Strader Cypress Co.*, 34 So. 857, 859;

held that a director will be charged with notice of the action of a board meeting at which he was not present, whereby the president was directed to sell certain bonds for the company, so that if the president converts the bonds to his own use, the director cannot become a *bona fide* purchaser of them, being charged with notice that the bonds were held in trust for the company.¹ These doctrines of constructive knowledge, however, operate only against the directors, and cannot be invoked against the corporation.² On the other hand, they operate in favor of strangers as well as in favor of the company. Moreover, a court or jury may always draw the inference or indulge the presumption, even as against the company, that its directors actually possessed such knowledge as they ought to have acquired by due attention to duty; but this is not a doctrine of constructive notice, as the inference or presumption may be rebutted by proof that the directors did not in fact have knowledge.

§ 1539-§ 1542. *Liability for confiding in executive Officers and Agents.*

§ 1539. **In general — Right to rely on supposedly honest and capable Officers.** — Obviously, directors of a large company cannot be expected to attend personally to all its multifarious affairs; they must employ agents and servants, and rely upon them. Their power to delegate their own functions to a committee or to sub-agents is elsewhere discussed.³ The precise

110 La. 877 (director held not a purchaser without notice of a vendor's lien on property of the company); *Sun Printing, etc. Ass'n v. Moore*, 183 U. S. 642, 650-651; 22 Sup. Ct. 240 (directors, and through them the corporation, charged with notice of authority which general manager claimed to be exercising); *Smith v. Bank of New England*, 72 N. H. 4; 54 Atl. 385 (ratification of contract inferred from the fact that the directors ought to have known of it).

¹ *Greenville Gas Co. v. Reis*, 54 Oh. St. 549; 44 N. E. 271. In the same case, the court held that a mere shareholder was not charged with

this constructive notice, and might therefore become a *bona fide* purchaser of the bonds.

² Cf. *Murray v. Nelson Lumber Co.*, 143 Mass. 250; 9 N. E. 634 (where the question was whether an unauthorized act of an agent had become binding on the company by ratification by the directors with knowledge of all material facts); *Pacific Vinegar, etc. Works v. Smith* (Cal.), 93 Pa. 85; *First Nat. Bank v. Drake*, 29 Kans. 311; 44 Am. Rep. 646. As to imputing knowledge of directors to the company, see also

supra, § 1488.

³ Supra, § 1467-§ 1469.

degree of supervision which they ought to exercise over their subordinates is impossible to define. In no case will they be liable, however, unless their negligence is more than an error of judgment. Thus, where dividends were shown to be payable by false balance sheets, a director who, being a country gentleman and wholly unfamiliar with bookkeeping, confided entirely in the general manager (to whom the constitution of the company gave an unusual degree of authority) was exonerated from liability for paying the dividends.¹ The same principle, that directors are entitled to rely upon the advice of a supposedly honest and competent official of the corporation, has been applied by the House of Lords² and by the United States Supreme Court.³ Directors need not be constantly suspicious; business can only be conducted on a footing of mutual trust.

So, directors are not liable for failing to examine the books kept by a supposedly honest officer although an examination by any one conversant with bookkeeping would have detected a defalcation.⁴ And the mere fact that the cashier whom they employ was known to have indulged some time before in specu-

¹ *Denham & Co.*, 25 Ch. D. 752. 488; This case goes a great way, since the dividends were in fact paid out of capital, so that the director having thus acted *ultra vires* was obliged to excuse himself by establishing a reasonable mistake of fact. See *supra*, § 1523.

² *Dovey v. Cory* (1901), A. C. 477; *Prefontaine v. Grenier* (1907), A. C. 101.

³ *Briggs v. Spaulding*, 141 U. S. 132; 11 Sup. Ct. 924. This case was decided under the National Bank Act, which expressly authorized the business to be carried on either by the directors or by the officers; and this circumstance may be seized upon as a distinction in some states.

See also *Bloom v. Nat. Saving, etc. Co.*, 152 N. Y. 114; 46 N. E. 166; *Wallace v. Lincoln Savings Bank*, 89 Tenn. 630; 15 S. W. 448; 24 Am. St. Rep. 625; *Savings Bank of Louisville's Assignee v. Caperton*, 87 Ky. 306; 8 S. W. 885; 12 Am. St. Rep.

Warner v. Penoyer, 91 Fed. 587; 33 C. C. A. 222; 44 L. R. A. 761; *Dunn's Adm'r v. Kyle*, 14 Bush. (Ky.) 134; *Scott v. Depeyster*, 1 Edw. Ch. (N. Y.) 513; *Johnson v. Stoughton Wagon Co.*, 95 N. W. 394; 118 Wisc. 438; *Mason v. Moore*, 73 Oh. St. 275; 76 N. E. 932; *Rankin v. Cooper*, 149 Fed. 1010 (where directors were exonerated for losses that occurred before, but held liable for losses that occurred after, notice or warning of president's misconduct).

As to the right of directors to rely on the legal advice of their solicitor, see *Spering's Appeal*, 71 Pa. St. 11; 10 Am. Rep. 684.

⁴ *Savings Bank of Louisville's Assignee v. Caperton*, 87 Ky. 306; 8 S. W. 885; 12 Am. St. Rep. 488. Cf. *Marshall v. Savings Bank*, 85 Va. 676; 8 S. E. 586; 17 Am. St. Rep. 84; 2 L. R. A. 534.

But see *Campbell v. Watson*, 62 N. J. Eq. 396; 50 Atl. 120.

lation is not enough to charge them as a matter of law with responsibility for his misconduct in the office.¹

Directors are not bound to suspect fraud or wrong behind an apparently innocent transaction.² A director who assents to a resolution approving a transfer of shares is not liable because, unknown to him, the transferee was a trustee for the company.³ So, a director assenting to the borrowing of money is not liable because he did not inquire the purpose for which the funds were to be used, the object to which they were put being in fact *ultra vires*.⁴

§ 1540. *Dixon v. Kennaway & Co.* — A novel application of the principle that directors are justified in intrusting mere administrative matters to executive officers or subordinate agents is exhibited by a recent English case. A transfer of shares had been executed by a person who really owned no shares in the company. The directors passed the transfer, and the secretary prepared and signed a certificate of shares for the transferee. The issue of this certificate was approved by the board of directors, although the denoting numbers of the shares specified therein were those of shares held by one of the directors. The court held that the director in question, who failed to observe the numbers of the shares specified in the certificate, was entitled to rely on the secretary to attend to such details, and was therefore not estopped from setting up his own title to the shares against that of the holder of the certificate.⁵

§ 1541. **Duty to watch Officers and Agents.** — Nevertheless, the whole duty of directors is not performed by employing agents of good character and skill; they must watch them with ordinary diligence,⁶ and certainly must not abdicate, virtually, their proper function of supervision.⁷ On this principle directors are

¹ *Ricker v. Hall*, 69 N. H. 592; U. S. 132; 11 Sup. Ct. 924 (semble); 45 Atl. 556.

² But cf. *Montgomerie's Brewery Co.*, 27 Vict. L. R. 175, 195-196.

³ *Ashurst v. Mason*, 20 Eq. 225. Wise. 438; *Fletcher v. Eagle* (Ark.),

⁴ *Land Credit Co. v. Fernory*, 5 86 S. W. 810; *Gibbons v. Anderson*, 80 Fed. 345.

Cf. *Perry's Case*, 34 L. T. 716.

⁵ *Dixon v. Kennaway & Co.* *herd*, 36 Ch. D. 787. (1900), 1 Ch. 833.

⁶ *Fisher v. Parr*, 92 Md. 245; 48 Mo. 380; 49 S. W. 1012; 71 Am. St. Atl. 621; *Briggs v. Spaulding*, 141 Rep. 615; *Warren v. Robinson*, 19

⁷ *Union Nat. Bank v. Hill*, 148

liable for voting large sums for preliminary or other miscellaneous expenses without requiring either an itemized account or any report of a finance committee.¹

§ 1542. **Statutory Liabilities for Misconduct of Officers.** — In California a constitutional provision makes directors liable for all “moneys embezzled or misappropriated” by an officer.² It is held that this provision makes the directors virtually sureties for the officers, and should therefore be strictly construed. Accordingly, liability is confined strictly to cases where *money* is misappropriated, and, for example, does not apply where an officer’s wrong consists in misappropriating or misusing treasury stock.³

§ 1543–§ 1547. *Liability of one Director for Acts of Co-directors.*

§ 1543. **In general.** — Closely akin to the matter of the liability of directors for acts of executive officers and agents is the subject of a director’s liability for the acts of his co-directors in which he has not concurred. The rule is, that ordinarily there is no such liability.⁴ A director is not bound to attend every meeting of the board, and is therefore not ordinarily liable for what his co-directors do in his absence.⁵ Hence, a director who concurred in the passage of a resolution declaring that a certain *ultra vires* course of action would thereafter be the policy of the board, was held not to be liable for the action of a subsequent meeting, at which he was not present, carrying into

Utah 289; 57 Pac. 287; 75 Am. St. Rep. 734. *Brown*, 8 Eq. 381, 401; *Lunds Allotment Co.* (1894), 1 Ch. 616; *London Trust Co. v. Mackenzie*, 62 L. J. Ch. 870, 876; *Ashurst v. Mason*, 20 Eq. 225; *Denham & Co.*, 25 Ch. D. 752; *Fisher v. Graves*, 80 Fed. 590; *Lucas v. Fitzgerald*, 20 Times L. R. 16; *People v. Equitable Life Ass. Soc.*, 109 N. Y. Supp. 453.

¹ *Liverpool Household Stores*, 62 L. T. 873; *Marzetti’s Case*, 42 L. T. 206 (distinguishing *Land Credit Co. v. Fermory*, 5 Ch. 763).

Cf. *Mann v. Edinburgh Northern Tramways Co.* (1893), A. C. 69.

² *Winchester v. Howard*, 136 Cal. 432 (overruling objections to the validity of the provision based upon the Fourteenth Amendment to the United States Constitution, and holding the provision to be self-executing). Cf. *Metropolitan, etc. Ry. Co. v. Kneeland*, 120 N. Y. 134, 144 (head-note inadequate); 24 N. E. 381; 17 Am. St. Rep. 619; 8 L. R. A. 253.

³ *Hercules Oil Ref. Co. v. Hocknell* (Cal.), 91 Pac. 341.

⁴ *Joint Stock Discount Co. v.* (Md.), 66 Atl. 291.

effect the *ultra vires* policy.¹ From the first resolution, which was a mere statement of intention, no damage resulted to the company, in legal contemplation; and the defendant had not concurred in the second resolution and was consequently not liable therefor. So, in a proceeding against a director for negligence, a mere allegation that the board of which he was a member was guilty of negligent acts without averring personal participation therein by the defendant has been held to be bad on demurrer.²

On the other hand, a director's duty is to be awake and not asleep; and hence, from Lord Hardwicke's time, it has been held that a director who has been guilty of "gross non-attendance" or other inattention to duty may be liable for breaches of trust committed in his absence by his fellows;³ and the difficulty of ascertaining in such a case the precise amount of damage occasioned by the default of each director is no reason for refusing relief to the company.⁴ Any such liability arises, however, out of a breach of duty owed to the corporation alone; and hence gives the several shareholders no individual cause of action.⁵ A director who on account of illness is given a leave of absence by the board is justified in going abroad, and is not liable for breaches of trust committed by his colleagues in his absence.⁶ Where some of the directors are appointed an examining committee charged with the duty of examining the company's accounts, the members of the committee are liable

¹ *Cullerne v. London, etc. Bldg. Soc.*, 25 Q. B. D. 485; *Young v. Naval, Military, etc. Soc.* (1905), 1 K. B. 687.

² *Fisher v. Graves*, 80 Fed. 590.

But see contra: *Fisher v. Parr*, 92 Md. 245; 48 Atl. 621. It is submitted that the demurrer in the latter case was properly overruled since there seems to have been a sufficient allegation of negligence by inattention to the conduct of the co-directors; but on the other hand it is submitted that the proposition in the text which is supported by the former case is preferable to some of the dicta on the point in the latter case.

³ *Charitable Corporation v. Sutton*, 2 Atk. 400, 405; *Williams v. McKay*, 40 N. J. Eq. 189, 200-203; 53 Am. Rep. 775.

Cf. *Rankin v. Cooper*, 149 Fed. 1010, 1016-1017 (holding that absence of director on account of private business is no excuse).

⁴ *Charitable Corporation v. Sutton*, 2 Atk. 400, 406.

Cf. *Williams v. McKay*, 40 N. J. Eq. 189, 203-204 (headnote inadequate); 53 Am. Rep. 775.

⁵ *Infra*, § 1636.

⁶ *Briggs v. Spaulding*, 141 U. S. 132, 155; 11 Sup. Ct. 924.

for failing to use due diligence in the examination, but the other members of the board who rely on their report incur no liability.¹

§ 1544. **Duty of Director on learning of Misconduct of Colleagues.** — If a director learns that his colleagues are engaged in fraudulent or *ultra vires* transactions, his duty requires him to investigate, and remonstrate promptly and vigorously;² and if he fail to do so, he will be liable for the wrongs which they thereafter commit. A protest which is withdrawn before the objectionable action is finally taken is of course of no avail to the protesting director.³ Indeed, it has been said that where his protest is not heeded by his co-directors, he can guard himself from liability for their actions only by applying to the courts for an injunction.⁴ In a case of threatened serious harm to the company, perhaps that course ought to be pursued; but in a case of some trivial matter only technically *ultra vires*, probably so severe a rule would not be insisted upon. At all events, where the threatened misconduct on the part of co-directors consists not in fraudulent or *ultra vires* acts but in mere negligence, an earnest protest will always be sufficient,⁵ since judicial intervention is impossible under the rule in *Foss v. Harbottle*.

§ 1545. **Liability for ex post facto Approval of Misconduct of Co-directors.** — Ordinarily, a director's approval, *ex post facto*, of misconduct by his colleagues to which he was not at the time privy, does not subject him to liability therefor.⁶ Hence, a director who was not present when a resolution determining upon an *ultra vires* investment was passed is not rendered liable by presence at the next meeting when the minutes of the preceding were read and approved;⁷ but one who had given ground to believe that he would approve of such an *ultra vires* proceeding

¹ *Warner v. Penoyer*, 91 Fed. 587; 33 C. C. A. 222.

Cf. *Hanna v. People's Nat. Bank*, 35 N. Y. Misc. 517; 71 N. Y. Supp. 1076, reversed on other grounds, 76 N. Y. App. Div. 224.

² *Joint Stock Discount Co. v. Brown*, 8 Eq. 381; *Jackson v. Munster Bank*, 15 L. R. Ir. 356.

³ *Ramskill v. Edwards*, 31 Ch. D. 100.

⁴ *Joint Stock Discount Co. v.* p. 1217, n. 1.

Brown, 8 Eq. 381, 403; *Jackson v. Munster Bank*, 15 L. R. Ir. 356.

⁵ *Grimwade v. Mutual Society*, 52 L. T. 409, 417, 418.

⁶ *London Trust Co. v. Mackenzie*, 62 L. J. Ch. 870, 876; *Hoole v. Speak* (1904), 2 Ch. 732.

⁷ *Lands Allotment Co.* (1894), 1 Ch. 616. As to the effect of a vote approving the minutes of a previous meeting, see also *supra*, § 1243, and

and who subsequently does approve of it and identify himself therewith is liable.¹

§ 1546. **Liability for executing wrongful Resolution of the Board.** — Directors who carry out an *ultra vires* resolution of the board by signing cheques, etc., cannot excuse themselves on the ground that they acted in obedience to the board's directions,² since the resolution, being *ultra vires*, was void, and ought to have been disobeyed. It is otherwise with a mere administrative officer, such as a secretary, who is to take his orders from the directors, and is not liable for obeying them.³ But such an officer who is also a director is as responsible as any other director would be; his additional duties as officer do not relieve him from the duties and liabilities incumbent upon him as director.⁴

§ 1547. **Liability for failing to prosecute Breaches of Trust consummated by former Directors or by Co-directors.** — Directors are not bound to unearth and prosecute breaches of trust committed by their predecessors. Hence, a director who long before his election had learned of a breach of trust committed by the then directors is not liable for failing to institute proceedings against them to recover damages for the company.⁵ So it would seem that a director is not liable to the company for omitting to prosecute a breach of trust committed by one of his associates for which he would not otherwise be answerable. Thus, a director is not rendered liable for the misapplication of a cheque belonging to the company merely because he has ordered the amount thereof to be written off on the company's books.⁶

§ 1548. **Liability of Directors for Mismanagement Joint and Several.** — The liability of directors for mismanagement of the

¹ *Lands Allotment Co.* (1894), 1 Ch. 616; *Hutchinson v. Curtiss*, 45 N. Y. Misc. 484; 92 N. Y. Supp. 70 (question of liability for payment of unearned dividends); *Lucas v. Fitzgerald*, 20 Times L. R. 16.

² *Joint Stock Discount Co. v. Brown*, 8 Eq. 381, 405.

Cf. *Young v. Naval, Military, etc. Soc.* (1905), 1 K. B. 687.

³ See *infra*, § 1665.

⁴ *Ramskill v. Edwards*, 31 Ch. D. 100, 111, 112.

But see *Commercial Bank v. Chatfield*, 86 N. W. 1015; 127 Mich. 407; *Commercial Bank v. Chatfield*, 121 Mich. 641; 80 N. W. 712.

⁵ *Forrest of Dean Coal Co.*, 10 Ch. D. 450.

⁶ *George Newman & Co.* (1895), 1 Ch. 674.

company's affairs is joint and several. That is to say, all those directors who, by reason of concurrence in some wrongful act, or by reason of negligence, are responsible to the company for some damage suffered by it, are liable jointly and severally for the full amount thereof.¹ A release of some of the directors in consideration of payment of part of the amount claimed to be due will not, when made under the direction of a court of equity having charge of the liquidation of the corporation, and when the court did not intend it to have any such effect, result in releasing the other directors, but the amount paid by the compromising directors must be credited in reduction of the amount for which the other directors are liable.²

§ 1549. **Whether the Liability arises Ex Contractu or Ex Delicto.** — Some apparent difference of opinion exists as to whether a director's liability to his company for mismanagement, negligence, or the like, arises *ex delicto* or *ex contractu*. Thus, in England the liability has been declared to sound in contract,³ while in New York it has been treated as sounding in tort.⁴ Probably the true doctrine is that, like a carrier's liability, it may be regarded in either light — either as a violation of the duties which the law throws upon a director by virtue of his relationship, and therefore as sounding in tort, or as a breach of the implied assumpsit of every man who accepts such a position, to discharge the duties of his post with fidelity and zeal.

§ 1550. **Liability of Estate of Deceased Director.** — Since the liability of a director for violation of the duties of his office may be deemed to arise *ex contractu*, very clearly the company's right of action does not abate on his death but survives against his estate, the maxim *actio personalis moritur cum persona* having no application.⁵ Many cases could be found in which the liability of the executor or administrator has been enforced

¹ *Oxford Bldg. Society*, 35 Ch. D. 502, 516; *Leeds Estate, etc. Co. v. Shepherd*, 36 Ch. D. 787; *Cooper v. Hill*, 94 Fed. 582; 36 C. C. A. 402; *Mills v. Hendershot* (N. J.), 62 Atl. 542; *National Funds Ass. Co.*, 10 Ch. D. 118.

Cf. *Von Arnim v. American Tube Works*, 188 Mass. 515; 74 N. E. 680.

² *Murphy v. Penniman* (Md.), 66 Atl. 282, 289-291.

³ *Emma Silver Mining Co. v. Grant*, 17 Ch. D. 122.

Cf. *Sproul v. Standard Glass Co.*, 201 Pa. 103; 50 Atl. 1003.

⁴ *Hun v. Cary*, 82 N. Y. 65; 37 Am. Rep. 546; *Pierson v. Morgan*, 17 N. Y. Civ. Proc. Rep. 124.

See also *Coddington v. Canaday*, 157 Ind. 243; 61 N. E. 567.

⁵ *Warren v. Para Rubber Shoe Co.*, 166 Mass. 97, 104-105; 44 N.

without question.¹ But where by statute the directors who consent to the payment of a dividend when the company is insolvent, or who make loans to stockholders, are made jointly and severally answerable for the debts of the corporation, that statutory liability, being penal in nature, does not survive against the executor of a delinquent director.²

§ 1551-§ 1555. *Procedure for Enforcement of Liability for Mismanagement.*

§ 1551. **Remedy at Law and in Equity.** — We have seen that directors may be proceeded against in equity for mismanagement.³ They are also liable at law in an action on the case.⁴

§ 1552. **Joinder of Claims and of Parties Defendant.** — In an action at law, claims against several directors whom it is not sought to make jointly liable for the full amount claimed are improperly joined;⁵ but it is otherwise in equity.⁶ Thus, a

E. 112; *Wineburgh v. U. S. Steam, etc. Advertising Co.*, 173 Mass. 60; 53 N. E. 145; 73 Am. St. Rep. 261; *Warren v. Robinson*, 21 Utah 429; 61 Pac. 28; *O'Brien v. Blaut*, 17 N. Y. App. Div. 288; 45 N. Y. Supp. 217; *Pierson v. Morgan*, 17 N. Y. Civ. Proc. Rep. 124 (treating the action as sounding in tort); *Boyd v. Schneider*, 131 Fed. 223, 229; 65 C. C. A. 209 (the action being by creditors); *Von Arnim v. American Tube Works*, 188 Mass. 515; 74 N. E. 680; *Lindemann v. Rusk* (Wisc.), 104 N. W. 119; 125 Wisc. 210; *Allen v. Luke*, 141 Fed. 694.

Cf. *Ramskill v. Edwards*, 31 Ch. D. 100, 111; *Killen v. Barnes*, 106 Wisc. 546; 82 N. W. 536; *British Guardian Life Ass. Co.*, 14 Ch. D. 335 (holding that special statutory remedy by summons under § 65 of the Companies Act of 1862 cannot be pursued against executors of a director as they are not officials of the company).

But see *First Nat. Bank v. Briggs's Estate*, 70 Vt. 599; 41 Atl. 586; *Witters v. Foster*, 26 Fed. 737.

¹ E. g. *Re Sharpe* (1892), 1 Ch. 154.

² *Boston, etc. R. R. Co. v. Graves*, 80 Fed. 588.

³ *Supra*, § 1510.

⁴ *Franklin Fire Ins. Co. v. Jenkins*, 3 Wend. (N. Y.) 130 (semble). Cf. *Mason v. Henry*, 152 N. Y. 529; 46 N. E. 837.

⁵ *Dykman v. Keeney*, 154 N. Y. 483 (headnote inadequate); 48 N. E. 894; *Sayles v. White*, 18 N. Y. App. Div. 590; 46 N. Y. Supp. 194. Cf. *Bay City Bridge Co. v. Van Etten*, 36 Mich. 210.

⁶ *Charitable Corp. v. Sutton*, 2 Atk. 400, 406; *Ackerman v. Halsey*, 37 N. J. Eq. 356; *Fisher v. Parr*, 92 Md. 245; 48 Atl. 621; *Barry v. Moeller*, 59 Atl. (N. J.) 97; *Gray v. Fuller*, 17 N. Y. App. Div. 29.

Cf. *Bay City Bridge Co. v. Van Etten*, 36 Mich. 210; *Young v. Equitable Life Ass. Soc.*, 112 N. Y. App. Div. 760 (joinder of claims for damages due to positive wrongful acts of some directors and negligence of the others held proper).

But see *Emerson v. Gaither*, 103 Md. 564; *People v. Equitable Life Ass. Soc.*, 109 N. Y. Supp. 453.

bill in equity against directors is not multifarious because it embraces claims arising from acts of negligence in all of which each of the defendants could not have participated and also joins as defendant the company's treasurer who also had been guilty of breaches of duty.¹ Moreover, at law the executor or administrator of a deceased director cannot be joined as defendant with the surviving directors, but in equity such joinder is permissible.²

§ 1553. **Non-joinder of Co-directors as Defendants.**—Inasmuch as the liability of directors who have been guilty of mismanagement is joint and several and may perhaps be deemed to arise *ex delicto*, it follows that the non-joinder of other directors equally liable with those sued is no defence to a suit by the corporation to recover for such misconduct.³ In some cases the position has been taken that since directors can act only as a board, all or at least a majority should be joined in an action against them for official misconduct;⁴ but this view is contrary to the weight of authority. Although it be not necessary to join as defendants all the directors who participated in the misconduct, yet the declaration should allege that the board took the action complained of; for a count charging that a single director did certain acts which could only be done by the board has been held bad on demurrer.⁵

§ 1554. **Requisite Definiteness in Allegations of Bill or Declaration.**—Whether the suit be in equity or at law, the charges should in accordance with the ordinary principles of pleading be

¹ *Williams v. McKay*, 40 N. J. 567; *Gailther v. Bauernschmidt* (Md.), Eq. 189, 203-204 (headnote inadequate); 53 Am. Rep. 775.

Cf. *Horn Silver Mining Co. v. Ryan*, 42 Minn. 196; 44 N. W. 56, and cases cited in preceding note. As to joinder of third persons who confederate with directors in a breach of trust, see further, *Gray v. Fuller*, 17 N. Y. App. Div. 29.

² *Von Arnim v. American Tube Works*, 188 Mass. 515, 520-521; 74 N. E. 680.

³ *Fisher v. Parr*, 92 Md. 245; 48 Atl. 621; *Hun v. Cary*, 82 N. Y. 65, 79; 37 Am. Rep. 546; *Horn Silver Mining Co. v. Ryan*, 42 Minn. 196; 44 N. W. 56; *Coddington v. Canaday*, 157 Ind. 243; 61 N. E.

Cf. *Gaffney v. Colvill*, 6 Hill (N. Y.) 567, 573-574 (as to action for enforcement of a statutory liability of directors to shareholders and creditors).

⁴ *Franklin Fire Ins. Co. v. Jenkins*, 3 Wend. (N. Y.) 130; *Godbold v. Branch Bank*, 11 Ala. 191 (headnote inadequate); 46 Am. Dec. 211; *North Hudson, etc. Ass'n v. Childs*, 82 Wisc. 460, 474-475, 487; 52 N. W. 600; 33 Am. St. Rep. 57.

As to the civil law, see *Percy v. Millaudon*, 3 La. 568.

⁵ *Gaffney v. Colvill*, 6 Hill (N. Y.) 567, 571-573.

sufficiently definite to apprise the defendants of the real nature of the case against them.¹ Hence, a general allegation that the defendants lent money on improper security without specifying the time or circumstances is bad on demurrer.² So, an allegation that directors improperly contracted a number of loans aggregating more than a hundred thousand dollars and that a loss was sustained of about twenty-two thousand dollars, without specifying upon which of the loans the loss occurred, is too indefinite.³ *A fortiori* a general charge that the defendants neglected their duties without specifying the particulars of the alleged negligence is insufficient.⁴ A count alleging that the directors *caused* an unlawful act to be done, instead of asserting that they did the act, was held bad on special demurrer⁵ — a very technical decision.

A declaration or complaint charging fraud cannot be sustained by proof of negligence.⁶

§ 1555. **Summary Statutory Remedy in England under § 165 of Companies Act of 1862 and § 10 of Act of 1893.** — Consideration has already been given to the summary English remedy against directors under § 165 of the Companies Act of 1862 and under the Companies Act of 1893.⁷

§ 1556-§ 1560. DEFENCES.

§ 1556. **Limitations and Laches.** — Where the directors misapply the company's funds or otherwise act *ultra vires* or negligently, their liability is regarded, according to the weight of authority, as so far analogous to a breach of trust as not to be within the statute of limitation of 21 James I, c. 16, or any similar enactment.⁸ On the other hand, in such cases, the directors are

¹ As to what allegations are sufficiently definite, see, in addition to cases cited below, *McRee v. Mexican Gulf Oil, etc. Co.* (Ga.), 56 S. E. 451 (headnote inadequate); *Mutual Life Ins. Co. v. McCurdy*, 103 N. Y. Supp. 840; *Gaffney v. Colvill*, 6 Hill (N. Y.) 567, 578-579; *Mutual Life Ins. Co. v. McCurdy*, 103 N. Y. Supp. 829.

² *Franklin Fire Ins. Co. v. Jenkins*, 3 Wend. (N. Y.) 130.

³ *Murphy v. Penniman* (Md.), 66 Atl. 282, 286.

⁴ *Allen v. Luke*, 141 Fed. 694; *People v. Equitable Life Ass. Soc.*, 109 N. Y. Supp. 453.

⁵ *Gaffney v. Colvill*, 6 Hill (N. Y.) 567, 575-576, 580.

⁶ *Polhemus v. Polhemus*, 114 N. Y. App. Div. 781; 100 N. Y. Supp. 263.

⁷ *Supra*, § 1513.

⁸ *Flitcroft's Case*, 21 Ch. D. 519; *Re Sharpe* (1892), 1 Ch. 154; *Mu-*

within any statute of limitations applicable to trustees,¹ although laches of the corporation for less than the statutory period is no bar.² In one case where directors had paid dividends out of capital, although the claim against them for misconduct as directors was barred by a statute of limitations expressly made applicable to such suit, nevertheless the court held that the claim for repayment of the dividends received by them as shareholders was not barred; and that too, although a similar claim against the shareholders who were not directors was held to be barred by the statute.³ A statute of limitations applicable to actions against directors to enforce any liability "created by law" refers to liabilities created by statute law and not to those which existed at common law.⁴ As directors are not liable for misconduct unless damage results to the company, it follows that in no case can the statute of limitations begin to run in favor of a

municipal Freehold Land Co. v. Polington, 63 L. T. 238; *Williams v. McKay*, 40 N. J. Eq. 189, 196-199; 53 Am. Rep. 775 (with which compare *Williams v. Riley*, 34 N. J. Eq. 398); *Ellis v. Ward*, 137 Ill. 509; 25 N. E. 530; *Boyd v. Mutual Fire Ass'n*, 116 Wisc. 155; 90 N. W. 1086; 94 N. W. 171.

Cf. *Lawrence v. Stearns*, 79 Fed. 878, 883 (affirmed 83 Fed. 738); *Coxe v. Huntville Gas Co.*, 106 Ala. 373; 17 So. 626; *Pierson v. Morgan*, 20 Abb. N. C. (N. Y.) 428; *Brinkerhoff v. Bostwick*, 99 N. Y. 185; 1 N. E. 663; *Emerson v. Gaither*, 103 Md. 564 (holding that the statute begins to run from the time the misconducting director goes out of office); *Rankin v. Cooper*, 149 Fed. 1010, 1015-1016 (defence disallowed on the ground of "exceptional circumstances" and because delinquents, throughout the period when the statute was claimed to be running, constituted a majority of the board).

But see *Wallace v. Lincoln Savings Bank*, 89 Tenn. 630; 15 S. W. 448; 24 Am. St. Rep. 625; *Cooper v. Hill*, 94 Fed. 582; 36 C. C. A. 402; *Lexington, etc. R. R. Co. v.*

Bridges, 7 B. Monr. (Ky.) 556; 46 Am. Dec. 528; *Landis v. Saxton*, 105 Mo. 486; 16 S. W. 912; 24 Am. St. Rep. 403 (claim against company's secretary); *Cullen v. Coal Creek, etc. Co.*, 42 S. W. Rep. 693 (Tenn.); *Mason v. Henry*, 152 N. J. 529; 46 N. E. 837; *Stone v. Rottman*, 183 Mo. 552; 82 S. W. 76.

¹ *Lands Allotment Co.* (1894), 1 Ch. 616; *Whitman v. Watkin*, 78 L. T., n. s., 188.

Cf. *San Pedro Lumber Co. v. Reynolds*, 121 Cal. 74, 91; 53 Pac. 410; *Morgan v. King*, 27 Colo. 539, 558-559; 63 Pac. 416; *Figge v. Bergenthal* (Wisc.), 109 N. W. 581; 110 N. W. 798; *Montgomerie's Brewery Co.*, 27 Vict. L. R. 175 (holding that the trusts act of limitations cannot be availed of by directors who have misappropriated the company's property to their own benefit).

² *Ilion Bank v. Carver*, 31 Barb. (N. Y.) 230.

³ *Mills v. Hendershot* (N. J.), 62 Atl. 542 (stated and criticised supra, § 1368).

⁴ *Gores v. Field*, 109 Wisc. 408, 414, 417-418; 84 N. W. 867; 85 N. W. 411.

director until damage is sustained by the company from the misconduct.¹ A query has been suggested whether the laches of the company can ever be a bar to a right of action against the directors for proceedings which were *ultra vires* of the corporation and which therefore its acquiescence or approval could not have made lawful.²

In this section the discussion has been confined to cases where the corporation, or its receiver or other representative, is plaintiff; for a shareholder may doubtless be barred by his own laches from maintaining a shareholder's bill against the company's directors although an action or suit by the company would not be barred by limitations or laches.³

§ 1557. **Discharge of Director in Bankruptcy.** — Directors' acts of mismanagement or negligence in the conduct of the company's business are "breaches of trust" within the meaning of the bankruptcy acts, so that where a discharge is no bar to a *cestui que trust's* claim against a trustee for breach of trust, it is no bar to a corporation's claim against a director for mismanagement.⁴

§ 1558. **Set-off.** — Where directors have been guilty of actual fraud, it is, to say the least, doubtful whether they would be allowed to set off debts due from the company to themselves against the company's claim for mismanagement or the like. However, it should be borne in mind that the claim of the corporation for breach of trust by its directors may be deemed to arise *ex contractu*,⁵ so that set-off would not be inadmissible on the ground that the proceeding sounds in tort. At all events, where the directors have been guilty of no actual fraud, and where their liability could be enforced at law only by an action for money had and received, the right to set-off will be accorded them.⁶

¹ *Emerson v. Gaither*, 103 Md. 564, 581-582.

² *Re Sharpe* (1892), 1 Ch. 154, 168, 172. Cf. *Alexandra Palace Co.*, 21 Ch. D. 149; *Nant-y-Glo, etc. Iron-works Co. v. Grave*, 12 Ch. D. 738, 748-750.

³ See *supra*, § 1168.

⁴ *Flitcroft's Case*, 21 Ch. D. 519, 527; *Ramskill v. Edwards*, 31 Ch. D. 100, 112; *Warren v. Robinson*, 21 Utah 429; 61 Pac. 28. In *New*

York the same result is reached, but upon the ground that the director's liability arises *ex delicto*. *Hun v. Cary*, 82 N. Y. 65, 79-80; 37 Am. Rep. 546.

⁵ *Supra*, § 1549.

⁶ *Eastwick's Case*, 34 L. T. 84. *Quære*, whether this decision does not confuse the liability as receiver of the company's funds, which could be enforced only by action for money had and received, with

§ 1559-§ 1560. *Consent of Shareholders as Excuse for Directors.*

§ 1559. **In Cases of Ultra Vires Acts.** — In England the consent of all the members of the corporation to actions by the directors which are *ultra vires* of the company will not prevent the corporation, as a distinct legal entity, from holding the directors to account.¹ In many of the United States, however, the consent of all the shareholders would probably be held to prevent the corporation as then constituted from complaining of an *ultra vires* transaction engaged in by its directors;² and subsequent transferees of shares would perhaps stand on the same footing.³ In England as well as in the United States, a shareholder who has assented to *ultra vires* acts on the part of directors would be precluded from maintaining a shareholder's bill to make them liable therefor.⁴ Even in America, the consent of a mere majority of the shareholders to acts which are *ultra vires* of the corporation is clearly no defence to the directors.⁵

§ 1560. **In Cases of Fraud or Negligence.** — Where the acts of directors are *intra vires* of the company, the sanction of all its members is, in all jurisdictions, a sufficient protection against a suit by the corporation,⁶ or shareholders suing on its behalf, even though there was an actual fraudulent intent to injure subsequent shareholders⁷ or creditors. Each shareholder or creditor is remitted to his own individual action for his own damages against any person who by fraud may have misled him.⁸ The

the liability in damages for misconduct as director in consenting to an improper payment.

¹ *London Trust Co. v. Mackenzie*, 62 L. J. Ch. 870; *Society of Practical Knowledge v. Abbot*, 2 Beav. 559 (with which compare, however, *Gold Co.*, 11 Ch. D. 701).

As to a corporation's power to relinquish its right of action against its directors for engaging in transactions *ultra vires* of the company, see *London Financial Ass'n v. Kelk*, 26 Ch. D. 107, 151. See also, *Brockway Mfg. Co.*, 89 Me. 121; 35 Atl. 1012; 56 Am. St. Rep. 401; *Na-*

tional Funds Ass. Co., 10 Ch. D. 118.

² *Parsons v. Hayes*, 4 Abb. N. C. (N. Y.) 419; *Holmes v. Willard*, 125 N. Y. 75; 25 N. E. 1083; 11 L. R. A. 170. Cf. *supra*, § 1057.

³ *Parsons v. Hayes*, 14 Abb. N. C. (N. Y.) 419, 433, 435; *Langdon v. Fogg*, 14 Abb. N. C. (N. Y.) 435 n.

⁴ *Supra*, § 1167.

⁵ *Siegmán v. Electric Vehicle Co.* (N. J.), 65 Atl. 910.

⁶ Cf. *Innes & Co.* (1903), 2 Ch. 254 (headnote inadequate).

⁷ *Foster v. Seymour*, 23 Fed. 65.

⁸ *Ambrose Lake Tin Co.*, 14 Ch.

consent of the shareholders given in general meeting will bind all absentees, and those absent from the meeting have constructive notice of all facts disclosed by the directors to those present.¹ In case of actual fraud, the dissenting minority would not be bound. Moreover, the consent of the shareholders would be ineffective if obtained by fraud, or indeed if obtained without a full disclosure of all material facts.²

§ 1561-§ 1562. *Assignment of the Company's Claim.*

§ 1561. **In general.** — The company's claim against a director for misconduct may be assigned like any other chose in action. As will appear hereafter, it may pass under a general charge of all the company's property to secure an issue of debentures.³

§ 1562. **Upon Bankruptcy of the Company.** — If a director's liability for negligence or misconduct in office be deemed to arise *ex contractu*, it follows that a claim against a director on that account passes to the corporation's assignee in bankruptcy, and is not within an exception of claims for damages founded upon tort.⁴

§ 1563-§ 1606. **CONTRACTS OR DEALINGS BETWEEN A CORPORATION AND ITS DIRECTORS — TRANSACTIONS IN WHICH DIRECTORS HAVE AN INTEREST ADVERSE TO THE COMPANY — HOW FAR VALID.**

§ 1563. **The two underlying Principles — Transactions between a Trustee and himself individually always voidable — Transactions between a Trustee and his Cestui que Trust prima facie voidable, but valid if the utmost Good Faith be proved.** — A director's rights and liabilities will often be determined by the law which regulates the status of interested directors, and particularly by the answer to the question how far directors may lawfully deal with the company.

D. 390, 399; *Foster v. Seymour*, 23 Fed. 65, 66-67.

² Cf. *infra*, § 1590.

³ *Infra*, § 1875.

¹ *Ex parte Bignold*, 22 Beav. 143, 165.

⁴ *Mutual Bldg. Fund v. Bos-sieux*, 3 Fed. 817.

The general principles governing the subject are two. The first is the principle that no agent, trustee, or other fiduciary is permitted to contract with himself, or to represent his principal or *cestui que trust* in any transaction in which he himself has a private conflicting interest, and that if he undertake to do so the contract or transaction is voidable by the principal or *cestui que trust* without reference to the question whether or not the transaction was fair and beneficial to the latter.¹ The fiduciary is under an absolute disability, which indeed the *cestui que trust*, if he be *sui juris* and fully apprized of all material circumstances, may consent to remove, but which without such consent renders all such transactions voidable.

The second principle is that all contracts or dealings between a trustee and his *cestui que trust* are *prima facie* voidable, but that if the trustee can prove that he acted with the utmost good faith and made full disclosure of all material circumstances to the person towards whom he occupies a confidential relationship, then the transaction may stand.² In other words, the burden of proof is upon the fiduciary to show the utmost fairness and the fullest disclosure; but he is not under an absolute disability irrespective of the *bona fides* of the transaction, as a fiduciary is who undertakes to contract with himself or to represent his principal or *cestui que trust* in a transaction in which he himself has some adverse individual interest.

§ 1564—§ 1569. *Application of these two Principles to Dealings between Directors and their Company — Consideration of the Subject theoretically.*

§ 1564. **Difficulty in determining which of the two Principles should apply.** — In the application of these principles to the case of directors, who of course are fiduciaries, the chief difficulty lies in determining within which of these two principles a given case falls. In other words, the difficulty lies in determining whether a given contract or dealing between a director and his

¹ Underhill on Trusts and Trustees, 5th ed., Art. 46 (2), pp. 247–249; Lewin on Trusts, 11th ed., 251; Lewin on Trusts, 11th ed., 565–562, 563; 28 Am. & Eng. Enc. of Law, 2d ed., p. 1016 et seq., tit. “Trusts and Trustees,” VI, 9, b (1).
² Underhill on Trusts and Trustees, 5th ed., Art. 46 (3), pp. 250–251; Lewin on Trusts, 11th ed., 566; 28 Am. & Eng. Enc. of Law, 2d ed., p. 1020 et seq., tit. “Trusts and Trustees,” VI, 9, b (2).

company was entered into by the fiduciary with himself or with his *cestui que trust*, the imaginary corporate entity. The *cestui que trust*, being a fictitious person, can only act through the agency of natural persons; and on the other hand the director is a member of a board which constitutes, as it were, the incarnation of the corporation. Under what circumstances can it be said that the director has divested himself of his fiduciary capacity, and, representing himself alone, is dealing with his *cestui que trust*, the corporation? The difficulties attending this question may be simplified by classifying cases of dealings between a director and his company, and considering each class separately upon principle. The somewhat conflicting authorities may then be the more easily understood.

§ 1565. **Contracts authorized on behalf of the Company by the interested Director's own Vote.** — (1) A director proposes to enter into a contract with his company. The contract is made on behalf of the company by the board of which he is a member, and his vote is necessary to the passage of the resolution authorizing the contract. Here, surely, the contract falls within the category of contracts made by a trustee with himself individually, and according to the principle stated above should be held voidable at the option of the company, even if the interested director made the fullest disclosure to his associates, and even if the contract be in fact fair and even beneficial to the company.

§ 1566. **Contracts for which the interested Director votes but which have a sufficient majority without his Vote.** — (2) A director makes a contract with the corporation which is authorized on behalf of the company at a board meeting at which he attends and votes, but his vote is not necessary to the passage of the resolution. Here the question is more doubtful. As the interested director's vote was not necessary to the passage of the resolution, the argument is plausible that the contract should be regarded as made between the director, or trustee, on the one side, and the corporation, or *cestui que trust*, represented by the other directors, on the other; and that consequently the contract, being governed by the second of the two broad principles above stated, should be enforceable against the company if the interested director sustains the burden of proving affirmatively that he acted with the utmost good faith and that the contract was entirely fair to the company. An answer to this

argument is, however, that the influence of the interested director is not measured by his vote alone, but that his participation in the meeting, his arguments, and the weight of his judgment may have prevailed mightily with his colleagues, so that in substance he should be deemed to have made the contract, in part at least, on behalf of the company as well as on his own behalf. According to this view, the contract would be voidable even though the utmost good faith were proved.

§ 1567. **Contracts in making which the interested Director takes no part on behalf of the Company.** — (3) A director makes a contract with the company which is represented in the matter exclusively by the other directors, constituting a competent quorum of the board. This case is still stronger for the interested director; and with great force it may be argued that the interested director having acted solely on his own behalf has not occupied a dual relationship, and that therefore the contract should be subject to no more stringent a rule than that which governs a contract between a trustee and his *cestui que trust*. On the other hand, it may be said that a company is entitled to the disinterested advice of all its directors, and that no one of them has the right voluntarily to deprive the company of his advice — that the law should not permit a director to divest himself of his fiduciary character and to bargain with his colleagues.

§ 1568. **Contracts which are either previously authorized or subsequently ratified by the Shareholders.** — (4) A director enters into a contract with the company, and the contract is either previously specifically authorized or subsequently ratified by the shareholders in meeting assembled. Here, there can be no doubt that the contract falls within the category of contracts between a trustee and his *cestui que trust*. The shareholders constitute the corporation or *cestui que trust*. Consequently, although the contract is *prima facie* voidable in spite of the authorization or ratification by the shareholders, nevertheless if the interested director can prove affirmatively that he disclosed all material circumstances to the shareholders and that the question was fairly submitted to them, the contract should be enforceable.

§ 1569. **Contracts made by inferior Agent on behalf of the Company with a Director in his individual Capacity.** — (5) Where a director makes a contract with an inferior agent or officer, not

himself a director, the board of directors having no connection with the transaction, the question is complicated by the fact that the director's duty is to supervise and control in the interest of the company all the agent's actions, and that this position of the director is likely to induce the agent to sacrifice the company in order to please his superior. These circumstances are certainly sufficient to cause the court to subject the contract to rigid scrutiny, but not, it would seem, to bring the contract within the class of contracts made by a trustee with himself as distinguished from contracts made by a trustee with his *cestui que trust*. *A fortiori*, this is true where the agent did not know that the opposite party to the contract was a director.

§ 1570-§ 1606. *THE LAW OF THE SUBJECT AS ESTABLISHED BY JUDICIAL DECISION.*

§ 1570-§ 1571. *Transaction entered into on behalf of the Company by individually interested Directors voidable.*

§ 1570. *In general.* — The general principles applicable in legal theory to the subject having been set forth, it now remains to consider the law as established by the adjudicated cases. If the judicial decisions are not always in harmony with the results which have been advocated above as preferable in theory, at least the trend of authority is in accordance with sound principle. Thus, by the law as settled in England and in most of the United States, any contract, however fair in point of fact, entered into on behalf of the company by directors who have a personal interest therein other than as members of the company, or by directors any of whom whose vote is necessary to the authorization of the contract by a competent quorum is so individually interested, is voidable in equity at the option of the corporation.¹ To be sure, such a contract, especially if it be under the company's seal, has been held to be enforceable at law and

¹ *Wardell v. Railroad Co.*, 103 301; 40 N. E. 362; *Port v. Russell*, U. S. 651; *Gardner v. Butler*, 30 N. 36 Ind. 60; 10 Am. Rep. 5; *Sims* J. Eq. 702; *Ward v. Davidson*, 89 v. *Petaluma Gas, etc. Co.*, 131 Cal. Mo. 445; 1 S. W. 846; *Shattuck* 656; 63 Pac. 1011; *Stanley v. Luse*, v. *Oakland, etc. Co.*, 58 Cal. 551; 36 Oreg. 25; 58 Pac. 75; *Morgan Hoffman, etc. Co. v. Cumberland*, v. *King*, 27 Colo. 539; 63 Pac. 416; *etc. Co.*, 16 Md. 456; 77 Am. Dec. *Bank of Le Roy v. Purdy*, 100 N. Y. 311; *Higgins v. Lansingh*, 154 Ill. App. Div. 64; 91 N. Y. Supp. 310

voidable only in equity.¹ The contract not being void, but voidable in equity at the option of the company, it may always be enforced by the corporation.² The equitable principle applies although the interested directors are by statute or the company's regulations subject to some express penalty for making the contract, such as loss of office.³

It would seem clear that a modification or discharge of a contract which had been entered into between directors and the company before they became members of the board would be as objectionable as an entirely new contract.⁴ Thus, an agreement by officers of a corporation to give time to its debtor cannot operate to discharge those officers themselves as sureties of the

(contract made by president of a bank); *Pacific Vinegar, etc. Works v. Smith*, 145 Cal. 352; 78 Pac. 550; 104 Am. St. Rep. 42; *Attalla Iron Ore Co. v. Virginia Coal, etc. Co.* (Tenn.), 77 S. W. 774; 111 Tenn. (3 Cates) 527; *Goodell v. Verdugo Cañon Water Co.*, 138 Cal. 308; 71 Pac. 354; *Mobile Land, etc. Co. v. Gass*, 39 So. 229; 142 Ala. 520; and other cases too numerous to cite, many of which are referred to below.

But see *Buell v. Buckingham, etc. Co.*, 16 Iowa 284; 85 Am. Dec. 516; *Patterson v. Smelting Works*, 35 Oreg. 96, 107; 56 Pac. 407; *Strobel v. Brownell*, 16 N. Y. Misc. 657; 40 N. Y. Supp. 702; *Wyman v. Bowman*, 127 Fed. 257, 273; 62 C. C. A. 189; *Sacramento Bank v. Copsey*, 133 Cal. 663; 66 Pac. 8, 205; *Beach v. McKinnon*, 148 Fed. 734; *Stark Bank v. U. S. Pottery Co.*, 34 Vt. 144.

¹ *Foster v. Oxford, etc. Ry. Co.*, 13 C. B. 200 (explained in *Aberdeen Ry. Co. v. Blaikie*, 1 Macq. H. L. 461, 476, 482-483); *U. S. Rolling Stock Co. v. Atlantic, etc. R. R. Co.*, 34 Oh. St. 450, 464-465 (semble); 32 Am. Rep. 380; *Little Rock, etc. Ry. Co. v. Page*, 35 Ark. 304.

Cf. *Eales v. Cumberland Black-lead Mine Co.*, 6 H. & N. 481, which was a case of a parol contract sued upon at law. See also *Keans v.*

New York, etc. Ferry Co., 17 N. Y. Misc. 272; 40 N. Y. Supp. 366; holding that such a contract cannot be avoided by the company under a plea of "general denial." With the case last cited compare *New York Central Ins. Co. v. Nat. Protection Ins. Co.*, 14 N. Y. 85. There are some *dicta*, to which, however, no great weight need be attached, that such contracts are absolutely void. See *Wilbur v. Linde*, 49 Cal. 290; 19 Am. Rep. 645.

² *Wausau Boom Co. v. Plumer*, 35 Wisc. 274. See also *infra*, § 1605.

³ *Aberdeen Ry. Co. v. Blaikie*, 1 Macq. H. L. 461, 476 (distinguishing *Foster v. Oxford, etc. Ry. Co.*, 13 C. B. 200); *Imperial Mercantile Credit Ass'n v. Coleman*, L. R. 6 H. L. 189; *Hodge v. U. S. Steel Corp.*, 60 L. R. A. 742; 64 N. J. Eq. 807; 54 Atl. 1 (semble).

⁴ Cf. *Gallery v. Nat. Exchange Bank*, 41 Mich. 169; 32 Am. Rep. 149; *Wallace v. Oceanic Packing Co.*, 64 Pac. 938; 25 Wash. 143.

But see *Smith v. New Hartford Water Co.*, 73 Conn. 626; 48 Atl. 754.

As to the effect of a vote as director as a waiver of individual rights of director, see *infra*, § 1606.

debtor.¹ In the same way, a resolution of a board of directors will not suffice to take a claim of the directors themselves against the company out of the statute of limitations.² The adoption by directors of a contract which was made by promoters before incorporation and in which the directors have a personal interest is voidable just as an entirely new contract would be.³

§ 1571. **Bill in Equity by Corporation to set the Contract aside.** — Contracts between directors and their company being voidable in equity by the latter, it follows that the company may file a bill in equity to rescind or set aside the transaction. Numerous precedents for such a proceeding could undoubtedly be found. But in one case, the almost startling proposition seems to have been laid down that since such contracts are fraudulent in law, and since the fraud is deemed to be committed by the directors who are agents of the company, the latter being by its agents a party to the fraud cannot be allowed to file a bill to set aside the contract.⁴ This argument, however, wholly overlooks the fact that the fraud is committed not by, but against, the company. The case being, therefore, it is submitted, contrary to sound principle as well as to the authorities generally, is not likely to be followed.

§ 1572. **Where interested Director participates in Action of the Board but where his Vote is not a determining Factor.** — On principle, as stated above, the equitable doctrine by which contracts between directors and their company are voidable by the latter is applicable as well to each member of the board of directors as to a sole director. That is, a director may not unite with his colleagues, although they constitute a majority and a competent quorum of the board, in binding the company to a contract in which he has an independent interest.⁵ "The law cannot accu-

¹ *Leonhardt v. Citizens Bank*, 56 Nebr. 38; 76 N. W. 452.

² *Coleman v. Second Ave. R. R. Co.*, 38 N. Y. 201; *Lowndes v. Garnett Gold Mining Co.*, 33 L. J. Ch. 418 (semble).

³ *Munson v. Syracuse, etc. R. R. Co.*, 103 N. Y. 58, 75-76; 8 N. E. 355. See *supra*, § 334.

⁴ *Lewis v. Meier*, 14 Fed. 311. The actual decision can probably be supported upon the ground that some of the bonds had passed into the hands of *bona fide* purchasers, for such was probably the case.

⁵ *North Western Transportation Co. v. Beatty*, 12 A. C. 589, 593; *Aberdeen, etc. Ry. Co. v. Blaikie*, 1

ately measure the influence of a trustee with his associates.”¹ That an interested director has participated in the action of the board should be sufficient to render the contract voidable whether or not his vote was necessary to carry the matter through. Upon this principle, where one of the directors is a creditor of the company, a resolution of the board passed at a meeting at which he was present is insufficient to take the debt out of the statute of limitations.² So, a director cannot earn a reward offered by the corporation for the discovery of the perpetrator of a robbery.³

But although this principle is submitted to be sound, and is unequivocally supported by the English cases as well as by much authority in the United States, nevertheless some American courts hold that the contract will be enforceable although an interested director participated if there were enough disinterested votes to pass the resolution without counting his vote.⁴

§ 1573-§ 1575. *Where interested Director takes no Part in the Transaction on behalf of the Company.*

§ 1573. **General American Doctrine.**—Many courts which would not, perhaps, be willing to go to the length of the authorities cited in the last paragraph hold that if the interested director took no part either in the deliberations or in the voting of the

Macq. H. L. 461; *Munson v. Syracuse, etc. R. R. Co.*, 103 N. Y. 58, 74; 8 N. E. 355; *Metropolitan, etc. R. R. Co. v. Manhattan, etc. R. R. Co.*, 11 Daly (N. Y.) 373, 517; *Cumberland Coal Co. v. Sherman*, 30 Barb. (N. Y.) 553, 572-573; *Charter Gas Co. v. Charter*, 47 Ill. App. 36; *Ravenswood, etc. Ry. Co. v. Woodyard*, 46 W. Va. 558; 33 S. E. 285; *Kelsey v. Sargent*, 40 Hun (N. Y.) 150.

¹ *Munson v. Syracuse, etc. R. R. Co.*, 103 N. Y. 58, 74; 8 N. E. 355.

² *Lowndes v. Garnett Gold Mining Co.*, 33 L. J. Ch. 418 (semble).

³ *Stacy v. Bank of Illinois*, 5 Ill. 91.

⁴ *Clark v. Am. Coal Co.*, 86 Iowa 436; 53 N. W. 291; 17 L. R. A. 557; *Richards v. Attleborough Nat.*

Bank, 148 Mass. 187; 19 N. E. 353; 1 L. R. A. 781; *Porter v. Lassen, etc. Co.*, 127 Cal. 261; 59 Pac. 563; *Budd v. Walla Walla, etc. Pub. Co.*, 2 Wash. Ty. 347; 7 Pac. 896; *Schnittger v. Old Home, etc. Co.*, 144 Cal. 603, 607; 78 Pac. 9; *Tenison v. Patton*, 67 S. W. 92; 95 Tex. 284.

Cf. Graves v. Mono Lake, etc. Co., 81 Cal. 303, 320; 22 Pac. 665; *Ryan v. Williams*, 100 Fed. 172.

In *Fudickar v. East Riverside, etc. Dist.*, 109 Cal. 29; 41 Pac. 1024, a deed was held binding on a corporation although its seal was affixed thereto by the grantee as president of the company under the authority of the full board of directors. *Cf. Louisville, etc. Ry. Co. v. Carson*, 151 Ill. 444; 38 N. E.

board, but acted in the transaction wholly on his own behalf, the contract will not be voidable merely because of his official relation to the company, if the contract be proved affirmatively to be fair and honest.¹ Such is, indeed, the prevalent American doctrine. But even according to these authorities, the transaction will be closely scrutinized, and the burden of establishing its complete *bona fides* rests upon the interested director;² and if the interested director, although not guilty of positive fraud, yet failed to disclose some material fact, the transaction will be voidable.³ So too, if the agreement appear to be unconscionable or unreasonable, it will not be enforceable.⁴ Moreover, the contract will be voidable if the interested director presides over the meeting at which the contract is approved on behalf of the company.⁵ Where the resolution of the directors relied upon consists of several inseparable parts, then, according to all the best authorities, the transaction is voidable if the vote of any director interested in any part of the resolution was necessary to its passage.⁶

¹ *Fort Payne Rolling Mill v. Hill*, 174 Mass. 224; 54 N. E. 532; *Gamble v. Queens County Water Co.*, 123 N. Y. 91; 25 N. E. 201; 9 L. R. A. 527 (a mere *dictum*, the contract in question having been confirmed by the shareholders); *Ten Eyck v. Pontiac*, etc. R. R. Co., 74 Mich. 226; 41 N. W. 905; 16 Am. St. Rep. 633; 3 L. R. A. 378 (also a mere *dictum*, and for the same reason); *Beers v. New York Life Ins. Co.*, 66 Hun 75, 85-86; 20 N. Y. Supp. 788 (semble); *Singer v. Salt Lake Mfg. Co.*, 17 Utah 143; 53 Pac. 1024; 70 Am. St. Rep. 773; *Troy Mining Co. v. White*, 10 S. Dak. 475; 74 N. W. 236; 42 L. R. A. 549; (where a settlement of a claim against a director concluded by co-directors was held binding); *McNab v. McNab*, etc. Co., 62 Hun 18; 16 N. Y. Supp. 448 (affirmed in 133 N. Y. 687; 31 N. E. 627); *U. S. Rolling Stock Co. v. Atlantic*, etc. R. R. Co., 34 Oh. St. 450; 32 Am. Rep. 380; *Union Trust Co. v. Carter*, 139 Fed. 717.

See also *Ryan v. Williams*, 100 Fed. 172; *Eales v. Cumberland*

Blacklead Mine Co., 6 H. & N. 481; *Manufacturing Co. v. Bradley*, 105 U. S. 175.

² *Union Trust Co. v. Carter*, 139 Fed. 717, 731; *Saylor v. Commonwealth Investment, etc. Co.*, 62 Pac. 652; 38 Ore. 204; *Cumberland Coal, etc. Co. v. Parish*, 42 Md. 598.

Cf. *Crescent City Brewing Co. v. Flanner*, 44 La. Ann. 22; 10 So. 384.

But see contra: *Budd v. Walla Walla, etc. Pub. Co.*, 2 Wash. Ty. 347; 7 Pac. 896.

³ *Hicks v. Steel*, 126 Mich. 408; 85 N. W. 1121.

But see *Schnittger v. Old Home, etc. Co.*, 144 Cal. 603; 78 Pac. 9 (where the fact of the director's interest in the contract was not disclosed).

⁴ *Hubbard v. New York, etc. Investment Co.*, 14 Fed. 675.

⁵ *Beers v. New York Life Ins. Co.*, 66 Hun (N. Y.) 75, 85-87; 20 N. Y. Supp. 788; *Ashley v. Kinnan*, 2 N. Y. Supp. 574.

⁶ *Smith v. Los Angeles, etc. Ass'n*, 78 Cal. 289; 20 Pac. 677.

Cf. *Haywood v. Lincoln Lumber Co.*, 64 Wisc. 639, 648 (headnote inadequate); 26 N. W. 184; *Jones*

§ 1574. **English Doctrine.** — The English cases do not agree with this American doctrine, but hold that a transaction in which one of the directors has an adverse personal interest is voidable by the company even though his co-directors alone acted for the corporation in the matter,¹ and some American authorities agree.² This is the more logical view; for the company is entitled to the disinterested services and advice of all the directors,³ so that no one of them has any right to divest himself of his fiduciary capacity by acting antagonistically to the corporation.⁴ A distinction should be made between a mere servant or agent who is bound to be devoted to the company's interests only while he is about its business, and a director or trustee who should be disinterestedly loyal all the time. Nevertheless, the English rule, although the more logical, is too strict to be convenient in practice.

§ 1575. **Decisions of the Supreme Court of the United States.** — The authority of the Supreme Court of the United States is often claimed for the distinctively American view as distinguished from the English rule stated in the preceding paragraph, and the

v. Morrison, 31 Minn. 140, 149; 16 N. W. 854 (decision as to Murdock's salary); *Funsten v. Funsten Co.*, 67 Mo. App. 559; *Young v. Naval, Military, etc. Soc.* (1905), 1 K. B. 687, 695-696; *McNab v. McNab, etc. Co.*, 62 Hun 18; 16 N. Y. Supp. 448 (affirmed in 133 N. Y. 687; 31 N. E. 627); *Stewart v. Lehigh Valley R. R. Co.*, 38 N. J. Law, 505, 523 (semble).

¹ *Imperial Mercantile Ass'n v. Coleman*, L. R. 6 H. L. 189. Cf. *Flanagan v. G. W. Ry. Co.*, 7 Eq. 116.

But see *Eales v. Cumberland Blacklead Mine Co.*, 6 H. & N. 481; *Adamson's Case*, 18 Eq. 670 (head-note inadequate).

² *Colton Improvement Co. v. Rich-ter*, 26 N. Y. Misc. 26; 55 N. Y. Supp. 486 (holding that a contract between a director and his company cannot be confirmed by his co-directors, but only by the shareholders); *Cumberland Coal Co. v. Sherman*, 30 Barb. (N. Y.) 553, 572-

573; *Hoyle v. Plattsburgh, etc. R. R. Co.*, 54 N. Y. 314 (semble); *Mosher v. Sinnott*, 79 Pac. (Colo.) 742.

Cf. *Griffith v. Blackwater Boom, etc. Co.*, 46 W. Va. 56; 33 S. E. 125; s. c. 55 W. Va. 604; 48 S. E. 442; 69 L. R. A. 124.

³ *Aberdeen Ry. Co. v. Blaikie*, 1 Macq. H. L. 461, 473.

⁴ Said Dixon, J., in *Stewart v. Lehigh Valley R. R. Co.*, 38 N. J. Law 505, 523: "Nor is it proper for one of a board of directors to support his contract with his company upon the ground that he abstained from participating as director in the negotiations for and final adoption of the bargain by his co-directors, the very words in which he asserts his right declare his wrong; he ought to have participated, and in the interest of the stockholders, and if he did not, and they have thereby suffered loss, of which they shall be the judges, he must restore the rights he has obtained."

case of *Twin-Lick Oil Co. v. Marbury*¹ is cited in support of this claim. Although the report does not set out the facts very fully, yet the decision seems to have been misconstrued. The question was as to the validity of mortgage bonds issued by a company to one of its directors. The court declared that a contract between a corporation and a director is not void but merely subject to close scrutiny on account of the latter's fiduciary position. Apparently, the contract was entered into on behalf of the company not by the co-directors but by the corporation at large — that is, by the shareholders. At least, such is the natural inference from expressions used in the opinion of the court. If that be so, the case is in perfect harmony with the English doctrine. Moreover, the contract in question was a loan by the director to the corporation; and, as we shall presently see, loans are by many authorities differentiated from other contracts between a director and his company.²

In *Pneumatic Gas Co. v. Berry*,³ the headnote represents the court as deciding that a release of claims against a director executed by his co-directors on behalf of the company is valid; but if the releasee was a director when the release was made, that fact is certainly not disclosed by the report; and moreover the court distinctly decided that, independently of the release, any claim the corporation might once have had was barred by laches and acquiescence.

The decision of the Supreme Court that, perhaps, lends most color to the prevalent American rule is *Manufacturing Co. v. Bradley*.⁴ There, a director who had purchased a non-negotiable bond issued by the company entered into a special agreement with the other directors by which, in consideration of forbearance to sue on his part, the company agreed to pay to bearer the amount of his claim together with a high rate of interest. This agreement the court sustained, holding that the bond was thereby made negotiable. But, even in this case, the director in question recovered only the amount to which he was lawfully entitled by ownership of the bond; it was really a case of loan by the director to the corporation, and as mentioned above

¹ *Twin-Lick Oil Co. v. Marbury*, 113 U. S. 322; 5 Sup. Ct. 91 U. S. 587.

² *Infra*, § 1596.

⁴ *Manufacturing Co. v. Bradley*,

³ *Pneumatic Gas Co. v. Berry*, 105 U. S. 175.

loans of that sort stand upon a footing in some respects different from other contracts.¹

§ 1576. **Transactions between Directors acting individually and the Shareholders representing the Corporation.** — As stated above,² contracts between directors, acting solely on their own behalf, and the shareholders, representing the company, are governed by the same principle as contracts between a trustee and his *cestui que trust*, and are therefore binding provided the utmost good faith on the part of the directors be clearly established. Such contracts are, however, very rare. But the ratification by the shareholders of contracts entered into by the directors, or some of them, acting individually, and the company represented by themselves or their co-directors is common, and is governed by the same principle. This matter of ratification will be considered below at length.³

§ 1577. **Transactions between Directors acting individually and inferior Agents representing the Company.** — Even according to the English view, it would seem that transactions between a director and inferior agents of the company, particularly where the fact of agency for the company is not disclosed, should not be voidable if entirely fair in fact.⁴ Thus, if agents for a company should negotiate a purchase of land from a director without disclosing to the director the fact that they were acting on behalf of the company, the sale would be valid.⁵ So, a purchase by a director, not from his colleagues but from trustees who were appointed by the shareholders and whose selection he did not control, is quite valid unless proved affirmatively to be tainted with actual fraud.⁶

¹ *Infra*, § 1596.

² *Supra*, § 1568.

³ *Infra*, § 1588—§ 1592.

⁴ *Cf. Orr v. South Amboy Terra Cotta Co.*, 113 N. Y. App. Div. 103 (where, however, the court was acting under the influence of the prevalent American doctrine that a contract between a director and his co-directors as representatives of the company is not necessarily voidable).

⁵ *Cf. Freeman v. Sea View Hotel Co.*, 57 N. J. Eq. 68; 40 Atl. 218.

As to dealings between a director acting on his own behalf or as agent for a stranger and some officer or agent of the company, see *St. Johns Nat. Bank v. Steel*, 97 N. W. 704; 135 Mich. 165; *Kitchens v. J. H. Teasdale Commission Co.*, 79 S. W. 1177; 105 Mo. App. 463 (drafts by a cashier on his own bank).

⁶ *Kessler & Co. v. Ensley Co.*,

§ 1578-§ 1585. *Form of the Director's individual Interest.*

§ 1578. **Bribes or Presents from Third Persons having Dealings with the Company.** — The most objectionable form of interest which directors can have in any contract between their company and a third person consists in some present or bribe given to them by the opposite party in order to induce the execution of the contract. In most cases of this sort in the books, the company has affirmed the contract, and sought to recover the bribe or its value from the director;¹ but of course the company may avoid any contract obtained in that way.² Thus, where a construction company, two of whose members are directors of a railway corporation, bribes the other and disinterested directors of the latter company by agreeing to relieve them from the liability to the railroad on their shares of its stock, and so obtains a contract for the construction of the road, the railway company may rescind the contract.³ So, where directors accept a surrender of shares owned by certain discontented shareholders in consideration of the payment by the latter of debts owing to the directors from the company, the transaction is voidable by the corporation, so that the shareholders in question remain liable in respect of the surrendered shares.⁴ Similarly, where directors who are deputed to make a contract of sale on behalf of the company insert therein a clause giving them an option to sell property of their own at the same price, the purchaser cannot have specific performance against the company.⁵

§ 1579. **Directors acting as Agents for Party to a Contract with the Company.** — Clearly, the fact that a director in making a contract with his company represents as agent the opposite party subjects the contract to the same infirmity as if the director himself had been the principal.⁶ The law identifies an agent with

141 Fed. 130, affirmed, 148 Fed. 1019.

¹ *Infra*, § 1611.

² *European, etc. Ry. Co. v. Poor*, 59 Me. 277.

But see *Metcalf v. American School Furniture Co.*, 122 Fed. 115.

³ *Thomas v. Brownville, etc. R. R. Co.*, 109 U. S. 522; 3 Sup. Ct. 315.

⁴ *Cameron, etc. Ry. Co.*, 18 Beav. 339.

⁵ *Kelsey v. New England Street Ry. Co.*, 48 Atl. 1001; 62 N. J. Eq. 742.

⁶ *Cumberland Coal Co. v. Sherman*, 30 Barb. (N. Y.) 553.

But see *Pauly v. Pauly*, 107 Cal. 8; 40 Pac. 29; 48 Am. St. Rep. 98;

Leavitt v. Oxford, etc. Co., 3 Utah 265; 1 Pac. 356.

his principal. This would be true even if the director received no compensation for acting as agent; and indeed if compensation is paid, the payment amounts in effect to a bribe and brings the contract within the doctrine of the last paragraph.

§ 1580. **Contracts made with Company by Directors and Third Persons jointly.** — Where a director unites with outside parties in making a joint contract with the company, the strangers are affected with the same disabilities as himself, provided they have knowledge of his fiduciary position; and consequently the transaction is voidable against them all.¹ Indeed, it would seem to be immaterial whether the third persons have this knowledge or not, provided only it be possible to restore all parties to the *status in quo*, so that rescission may be had without injustice to them. Accordingly, where directors joined with outside parties in making a joint contract with the corporation — for example, where the contract was made by a firm of which the director was a member — rescission has been granted to the company, without stress being laid on the necessity of knowledge of the director's position on the part of the other joint contractors.²

§ 1581. **Transactions between the Company and another Corporation in which Directors of the first Company are Shareholders.** — The equitable doctrine that contracts in which directors have adverse private interests are voidable applies in strict logic not merely to contracts between the company and its directors, or between a company and a firm in which directors are partners, but also to all contracts in which directors have any interest, direct or indirect, adverse to that of the corporation. For example, it would apply to contracts with another company in which the directors or some of them are shareholders; and such perhaps

¹ *Hoffman, etc. Co. v. Cumberland, etc. Coal Co.*, 16 Md. 456, 509; 77 Am. Dec. 311; *Cumberland Coal Co. v. Sherman*, 30 Barb. (N. Y.) 553; *Ryan v. Leavenworth, etc. Ry. Co.*, 21 Kans. 365; *Sims v. Petaluma Gas Light Co.*, 131 Cal. 656; 63 Pac. 1011; *Wade v. Kendrick*, 37 Can. Sup. Ct. 32.

Cf. *Bramblet v. Commonwealth Land, etc. Co.* (Ky.), 83 S. W. 599; 26 Ky. Law Rep. 1176; 84 S. W.

545; 27 Ky. Law Rep. 156; *American Spirits Mfg. Co. v. Easton*, 120 Fed. 440 (where the company sought to recover the director's profits on the transaction).

As to giving security to a creditor whom directors have agreed to hold harmless, see *New Memphis Gas Light Co. Cases*, 105 Tenn. 268; 60 S. W. 206; 80 Am. St. Rep. 880. ² *Aberdeen Ry. Co. v. Blaikie*, 1 Macq. H. L. 461.

is the English rule.¹ Yet it would be almost intolerable in practice that a board of directors could have no dealings with another corporation in which one of them was a member;² and it has been held in New Jersey that the mere fact that directors of one company own shares in a corporation which owns a controlling interest in a rival corporation of the first company will not affect contracts between the first company and the rival company with any legal infirmity.³ It is scarcely necessary to mention that if directors enter into a contract, not *bona fide* for the good of the company, but in order to secure some private advantage to themselves as members of another corporation, the contract is everywhere voidable:⁴ it is obviously immaterial that the expected advantage is to accrue to them indirectly, as members of another company, and not directly.

§ 1582. **Transactions between Companies having common Directors.** — At any rate, it is clear that according to the English doctrine contracts between two corporations having common directors, entered into by or under the authority of their respective boards, are voidable at the option of either company.⁵ According to the prevalent American rule, the fact that there are common directors would not prevent binding agreements between the two companies if the common directors took no part

¹ *Metropolitan, etc. R. R. Co. v. v. Tacoma Smelting, etc. Co.*, 65 *Manhattan, etc. R. R. Co.*, 11 Daly Pac. 765; 25 Wash. 492.
(N. Y.) 373; *San Diego v. San* See also *Ernest v. Nicholls*, 6 H.
Diego, etc. R. R. Co., 44 Cal. 106, L. Cas. 401.
116 (semble); *Mitchell v. United* ² *Hill v. Gould*, 129 Mo. 106, 112;
Box Board, etc. Co. (N. J.), 66 Atl. 30 S. W. 181.
938 (where directors had under- Cf. *Mercantile Library Hall Co.*
written almost all the shares of v. *Pittsburgh Library Ass'n*, 173
of the second corporation); *James Pa. St. 30; 33 Atl. 744; Schofield*
Clark Co. v. Colton, 91 Md. 195, 216 v. *Nat. State Bank*, 97 Fed. 282,
(where payment by a director to a 290; 38 C. C. A. 179.
corporation in which he was the ³ *Pierce v. Old Dominion, etc.*
chief shareholder was declared *Smelting Co.*, 58 Atl. 319; 67 N. J.
to be equivalent to payment to Eq. 399.
himself).

⁴ *Wardell v. Railroad Co.*, 103 U. S. 651.
Cf. *Costa Rica Ry. Co. v. For-* ⁵ *Metropolitan Tel. Co. v. Do-*
wood (1900), 1 Ch. 756, 764 (affirmed *mestic Tel. Co.*, 44 N. J. Eq. 568,
(1901) 1 Ch. 746); *Boston Deep Sea,* 573; 14 Atl. 907; *Metropolitan, etc.*
etc. Co. v. Ansell, 39 Ch. D. 339; *R. R. Co. v. Manhattan, etc. R. R.*
City of London Electric Lighting Co. *R. R. Co.*, 11 Daly (N. Y.) 373; *Burden*
v. London Corporation (1901), 1 Ch. Co., 159 N. Y. 287, 307; 54
602; *Goodin v. Cincinnati, etc.* N. E. 17 (semble).
Canal Co., 18 Oh. St. 169; *Parsons*

in the negotiations. And even where the common directors participate in the transaction, some courts would uphold the contract, if it be quite free from fraud, provided the other directors constitute a majority of each board.¹ Indeed, some authorities go so far as to sanction dealings between two boards composed in part at least of common members without insisting on a necessity for a disinterested majority;² but without such a majority, according to the great weight of authority the transactions are voidable.³ So, a sale by the directors of one company to another corporation of which they constitute all the directors and shareholders would clearly be subject to the same infirmity as if they had personally been the vendees.⁴

Of course, a contract between boards of directors having common members may be ratified and confirmed by the shareholders of the respective companies; it stands upon no worse footing than other contracts in which directors have private interests.⁵ Consequently, where an agreement for consolidation

¹ *Booth v. Robinson*, 55 Md. 419, 441 (followed in *Davis v. U. S. Electric, etc. Co.*, 77 Md. 35, 41; 25 Atl. 982); *Rolling Stock Co. v. Atlantic, etc. R. R. Co.*, 34 Oh. St. 450; 32 Am. Rep. 380; *Jesup v. Illinois Central R. R. Co.*, 43 Fed. 483.

Cf. *Hagerstown Mfg. Co. v. Keedy*, 91 Md. 430; 46 Atl. 965; *City Nat. Bank v. Merchants', etc. Nat. Bank (Tex.)*, 105 S. W. 338.

² *Evansville Public Hall Co. v. Bank of Commerce*, 144 Ind. 34; 42 N. E. 1097; *Alexander v. Williams*, 14 Mo. App. 13; *Salina Nat. Bank v. Prescott*, 60 Kans. 490; 57 Pac. 121; *San Diego, etc. R. R. Co. v. Pacific Beach Co.*, 112 Cal. 53; 44 Pac. 333; 33 L. R. A. 788 (semble); *Barrie v. United Rys. Co. (Mo.)*, 102 S. W. 1078.

Cf. *Griffin v. Inman, Swann & Co.*, 57 Ga. 370; *Union Pac. R. R. Co. v. Credit Mobilier*, 135 Mass. 367, 377-378; *Robotham v. Prudential Ins. Co.*, 64 N. J. Eq. 673, 709-712; 53 Atl. 842; *City Nat. Bank v. Merchants', etc. Nat. Bank (Tex.)*, 105 S. W. 338.

³ *O'Conner, etc. Mfg. Co. v. Coosa Furnace Co.*, 95 Ala. 614; 10 So. 290; 36 Am. St. Rep. 251 (semble); *Bill v. Western Union Tel. Co.*, 16 Fed. 14; *Pearson v. Concord R. R. Corp.*, 62 N. H. 537; 13 Am. St. Rep. 590; *Fitzgerald v. Fitzgerald, etc. Co.*, 44 Nebr. 463; *San Diego v. San Diego, etc. R. R. Co.*, 44 Cal. 106 (headnote inadequate); 62 N. W. 899; *McLeod v. Lincoln Medical College*, 98 N. W. 672; 69 Nebr. 550; *Pittsburg, etc. Ry. Co. v. Dodd*, 72 S. W. 822, 827-828; 24 Ky. Law Rep. 2057; 115 Ky. 176; 74 S. W. 1096; *Continental Ins. Co. v. New York, etc. R. R. Co. (N. Y.)*, 79 N. E. 1026; 187 N. Y. 225 (semble).

Cf. *Greenwood Ice Co. v. Georgia Home Ins. Co.*, 72 Miss. 46; 17 So. 83.

⁴ *Abbot v. Am. Hard Rubber Co.*, 33 Barb. (N. Y.) 578, 593-595; *Parker v. Nickerson*, 112 Mass. 195, 197.

⁵ *Coe v. East & West R. R. Co.*, 52 Fed. 531, 543; *Jesup v. Illinois Central R. R. Co.*, 43 Fed. 483; *San Diego, etc. R. R. Co. v. Pacific*

of two corporations having common directors is not to be operative until confirmed by the shareholders of each company, a minority shareholder has no right to object to the consolidation on the mere ground of the part taken in the negotiations by the common directors.¹ So, too, the right to avoid a contract between corporations having common directors will be lost unless promptly exercised on learning of the facts.²

The fact that two corporations have certain officers in common does not render their books inadmissible in evidence in a suit by the one against the other;³ and does not render one company liable for neglect of duty owed by the common director to the other company.⁴

§ 1583. **Contract with Wife of a Director.** — It has been held that a contract between a corporation and the wife of a director is subject to the same infirmity as a contract with the director himself.⁵ If the husband acted in the matter on behalf of his wife, this conclusion would necessarily follow. Even if he did not so act, the doctrine would doubtless work well in practice, because the husband's interest in his wife's welfare would tend to bias his judgment as director; but nevertheless one may doubt whether so stringent a rule would be consistently adhered to by many courts.

§ 1584. **Contract with a Director assigned by him to Third Person.** — Where a contract between a corporation and a director was assigned by the contractor, with the assent of the company acting by its board of directors, to a disinterested third party, the Supreme Court of Massachusetts held that the contract then became binding.⁶ The case was a very peculiar one, entire

Beach, etc. Co., 112 Cal. 53; 44 Pac. 333; 33 L. R. A. 788; *Continental Ins. Co. v. New York, etc. R. R. Co.*, 103 N. Y. App. Div. 282; 93 N. Y. Supp. 27, and many other cases. Cf. *Colby v. Equitable Trust Co.*, 106 N. Y. Supp. 801; 55 N. Y. Misc. 355 (enjoining an agreement for consolidation of two companies having common directors, on the ground that although confirmed by the shareholders, it was unfair although not actually fraudulent).

¹ *Colgate v. U. S. Leather Co.* (N. J.), 67 Atl. 657, 663.

² *City Nat. Bank v. Merchants' Nat. Bank* (Tex.), 105 S. W. 338.

³ *Pauly v. Pauly*, 107 Cal. 8; 40 Pac. 29; 48 Am. St. Rep. 98.

⁴ *Elk Brewing Co. v. Neubert*, 213 Pa. 171; 62 Atl. 782; *Fitzgerald v. Fitzgerald, etc. Malory Co.*, 44 Nebr. 463; 62 N. W. 899. Cf. *supra*, § 1446.

⁵ *Voorhees v. Nixon* (N. J.), 66 Atl. 192 (headnote inadequate). Cf. *Davoue v. Fanning*, 2 Johns. Ch. (N. Y.) 252; *Lingke v. Wilkinson*, 57 N. Y. 445.

⁶ *Union Pac. R. R. Co. v. Credit Mobilier*, 135 Mass. 367.

good faith was affirmatively proved; and upon the whole one may well doubt whether the decision is to be taken as laying down any general rule. The mere assignment of a non-negotiable voidable contract without a novation and without any circumstance sufficient to estop the company from setting up its defence would seem to lend no additional validity to the contract.

§ 1585. **Private Interest of Director identical with Interest of Company.** — Of course, however, the equitable doctrine has no application where the directors' individual interest instead of being antagonistic to that of the company is identical with it. Thus, where a corporation has purchased the business of one P and agreed with him to assume all the debts thereof, his interest and the company's are identical, and therefore debentures issued by him as director for the corporation and accepted by his creditors in satisfaction of their claims are enforceable against the company.¹

§ 1586. **By-laws and other Regulations permitting Directors to contract with the Company.** — The company by its regulations may waive its right to the disinterested services of its directors; and hence, if its regulations expressly or impliedly authorize contracts between a director and the company, conditionally or otherwise, such contracts will be binding, provided those conditions, if any, be complied with. Thus, a clause in the articles of association providing that a director who should participate in profits made on dealings with the company (except as member of a firm or corporation) without disclosing his interest should forfeit his office, impliedly authorizes contracts between the company and a co-partnership or corporation of which a director is a member even without disclosure of his interest therein.² If dealings between a director and his company are sanctioned provided disclosure is made of his interest, a mere statement that he has an interest without disclosing its nature is

¹ *Seligman v. Prince* (1895), 2 Ch. 617. ² *Costa Rica Ry. Co. v. Forwood* (1900), 1 Ch. 756, affirmed (1901), 1 Ch. 746.

not a compliance with the condition on which the contract is allowed.¹ Where regulations or by-laws permit directors to contract with themselves "having regard to the interests of the company," directors who endeavor to maintain a contract with themselves must show affirmatively that in making it they had regard to the interest of the company.² In some of the United States, statutes sanction contracts between individual directors and the board of which they are members.³

§ 1587. **Statutes or By-laws declaring that Contracts with Directors shall be void.**— Sometimes, statutes or internal company regulations provide that contracts in which a director is interested shall be void.⁴ No such regulations should be construed to avoid a contract in which a director acquires an interest, by purchase or otherwise, after the contract is entered into.⁵

§ 1588-§ 1592. *Effect of Confirmation by Majority of the Shareholders of Contracts in which Directors are interested.*

§ 1588. **In general.**— While a conflict of authority exists as to the power of disinterested directors to contract on behalf of the company with a co-director where the company's regulations are silent on the subject, yet it is everywhere agreed that dealings between a company and one or all of its directors may be authorized or confirmed by the shareholders, and in that case will be binding.⁶ And such contracts so author-

¹ *Imperial Mercantile Ass'n v. Ashurst's Appeal*, 60 Pa. St. 290, Coleman, L. R. 6 H. L. 189. 314-315 (headnote misleading — a

² *Alexander's Timber Co.*, 70 L. J. Ch. 767.

³ *Hope v. Valley City Salt Co.*, 25 W. Va. 789, 807 (headnote inadequate).

⁴ As to such statutes see also *infra*, § 1598 and § 1605.

⁵ Cf. *City of London Electric Lighting Co. v. London Corporation* (1901), 1 Ch. 602.

⁶ *Hotel Co. v. Wade*, 97 U. S. 13, 21-23; *Sanford Fork & Tool Co. v. Howe, Brown & Co.*, 157 U. S. 312, 317; 15 Sup. Ct. 621; *Stewart v. Northern Inv. Co.*, 104 Iowa 393; *St. Louis, etc. Rail. Co.*, 41 Fed. 736; 73 N. W. 869; *Nye v. Storer*, 168

case where G., F., and G. as shareholders instructed themselves as directors to execute on behalf of the company a lease to themselves); *Warren v. Para Rubber Shoe Co.*, 166 Mass. 97; 44 N. E. 112; *Battelle v. Northwestern Cement Co.*, 37 Minn. 89; 33 N. W. 327; *Coe v. East & West R. R. Co.*, 52 Fed. 531; *Christopher v. Noron*, 4 Ont. 672; *Hodge v. U. S. Steel Corp.*, 60 L. R. A. 742; 64 N. J. Eq. 807; 54 Atl. 1; *Stetson v.*

ized or confirmed are not impeachable by creditors unless actually fraudulent.¹ If such transactions are to be authorized for the future, the regulations of the company must be altered, the required forms, if any, being observed, so that the regulations shall sanction such dealings; but any particular transaction of the kind in question may be confirmed by simple vote of a shareholders' meeting.²

§ 1589. **Whether Confirmation must be explicit—Effect of Acquiescence of Shareholders.**—The question of confirmation *vel non* should be explicitly submitted to the shareholders;³ but it is sufficient if a report containing a notice of the matter is read and adopted.⁴ Indeed, the approbation of the shareholders may be inferred from acquiescence,⁵ or the company's right of

Mass. 53; 46 N. E. 402; *Hayden v. Official Hotel Red Book Co.*, 42 Fed. 875; *Mt. Washington Hotel Co. v. Marsh*, 63 N. H. 230; *San Diego, etc. R. R. Co. v. Pacific Beach, etc. Co.*, 112 Cal. 53; 44 Pac. 333; 33 L. R. A. 788; *Robertson v. Bucklen & Co.*, 107 Ill. App. 369; *Mackey v. Burns* (Colo.), 64 Pac. 485; 16 Colo. App. 6; *Giveen v. Gans*, 91 N. Y. App. Div. 37; 86 N. Y. Supp. 450; 181 N. Y. 538; 73 N. E. 1124 (where the contract was made with the approval of the only other shareholder besides the plaintiff).

¹ *Sanford Fork & Tool Co. v. Howe, Brown & Co.*, 157 U. S. 312; 15 Sup. Ct. 621. See *infra*, § 1594.

² *Grant v. United Kingdom, etc. Co.*, 40 Ch. D. 135.

³ *Baker's Case*, 1 Dr. & Sm. 55, 65, 66.

But see *New York, etc. R. R. Co. v. Dixon*, 114 N. Y. 80, 87; 21 N. E. 110. Cf. *Martin v. Santa Cruz, etc. Co.*, 36 Pac. 36; 4 Ariz. 171; *Gardner v. Canadian Mfg. Co.*, 31 Ont. 488, 493-494 (headnote inadequate); *Farmers' L. & T. Co. v. San Diego Street Car Co.*, 45 Fed. 518, 527 (a case of a sweeping resolution ratifying "all the acts of the officers"); *Camden Land Co. v. Lewis*, 101 Me. 78; 63 Atl. 523.

⁴ *Murray's Executors' Case*, 5 De G. M. & G. 746. Cf. *Hadley & Co. v. Hadley*, 77 L. T. 131; *Martin v. Santa Cruz, etc. Co.*, 36 Pac. 36; 4 Ariz. 171; *Riley v. Loma Vista Ranch Co.* (Cal.), 82 Pac. 686.

⁵ *Warren v. Para Rubber Shoe Co.*, 166 Mass. 97; 44 N. E. 112; *Battelle v. Northwestern Cement, etc. Co.*, 37 Minn. 89; 33 N. W. 327; *Barr v. New York, etc. R. R. Co.*, 125 N. Y. 263; 26 N. E. 145; *Louisville, etc. Ry. Co. v. Carson*, 151 Ill. 444; 38 N. E. 140; *San Diego, etc. R. R. Co. v. Pacific Beach Co.*, 112 Cal. 53; 44 Pac. 333; 33 L. R. A. 788; *Foster v. Bear Valley, etc. Co.*, 65 Fed. 836; *Jesup v. Illinois Central R. R. Co.*, 43 Fed. 483; *Pacific Vinegar, etc. Works v. Smith*, 145 Cal. 352; 78 Pac. 550; 104 Am. St. Rep. 42; *Griffith v. Blackwater Boom, etc. Co.* (W. Va.), 48 S. E. 442; 55 W. Va. 604; 69 L. R. A. 124; s. c. 46 W. Va. 56; 33 S. E. 125; *Rosehill Cemetery Co. v. Dempster*, 79 N. E. 276; 223 Ill. 567.

Cf. *Mobile Land, etc. Co. v. Gass*, 39 So. 229; 142 Ala. 520 (where it was held, on the facts, that acquiescence had not been proved).

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rescission may be lost by laches.¹ Upon the same principle, an agreement or understanding between the boards of directors of two companies, composed largely of common directors, that business between the two corporations shall be transacted by the same person acting as agent for both — which agreement or understanding is acquiesced in by the shareholders of the two concerns — is valid, and the transactions entered into by the common agent cannot be upset by the receiver of one of the companies.²

§ 1590. **Necessity for full Disclosure to the Shareholders before the Confirmation.** — In order that the confirmation may be effective, full disclosure must be made by the interested director to the shareholders.³ Where the shareholders know that a director is interested and is making a profit on the transaction, it is not necessary that they should be informed of the *amount* of his profit.⁴ It has been held that confirmation by the shareholders is not binding unless made with knowledge that the transaction is voidable in law.⁵

§ 1591. **Objection of Minority Shareholders to Confirmation by Majority.** — The majority may confirm the contract; and it is, therefore, unless smirched with actual fraud, impregnable as against the attack of a minority shareholder.⁶ And the

¹ *Twin-Lick Oil Co. v. Marbury*, 91 U. S. 587, 591-594; *Goodwin v. Cincinnati, etc. Co.*, 18 Oh. St. 169; *Ashurst's Appeal*, 60 Pa. St. 290, 315-317; *Royal Bank v. Grand Junction R. R. Co.*, 125 Mass. 490; *Foster v. Mansfield, etc. Co.*, 146 U. S. 88; 13 Sup. Ct. 28 (a case of actual fraud).

For a case where laches was held not to be proved, see *Mallory v. Mallory Wheeler Co.*, 61 Conn. 131; 23 Atl. 708.

² *Roberts v. Washington Nat. Bank*, 11 Wash. 550; 40 Pac. 225.

³ *Hoffman, etc. Co. v. Cumberland Coal, etc. Co.*, 16 Md. 456; 77 Am. Dec. 311; *Cumberland Coal Co. v. Sherman*, 30 Barb. (N. Y.) 553, 573-576; *First Nat. Bank v. Drake*, 29 Kans. 311; 44 Am. Rep. 646 (where the supposed confirmation of the contract was by the dis-

interested directors, not the shareholders); *Pacific Vinegar, etc. Works v. Smith*, 145 Cal. 352; 78 Pac. 550; 104 Am. St. Rep. 42; *Camden Land Co. v. Lewis*, 101 Me. 78; 63 Atl. 523. *Supra*, § 1568.

But see *Hodge v. U. S. Steel Corp.*, 64 N. J. Eq. 807; 54 Atl. 1; 60 L. R. A. 742; *Stetson v. Northern Investment Co.*, 104 Iowa 393; 73 N. W. 869; *Schnittger v. Old Home, etc. Co.*, 144 Cal. 603; 78 Pac. 9 (where the fact of the director's interest was not disclosed).

Cf. *Continental Ins. Co. v. New York, etc. R. R. Co.*, 187 N. Y. 225; 79 N. E. 1026.

⁴ *Chesterfield, etc. Colliery Co. v. Black*, 37 L. T. 740.

⁵ *Hoffman, etc. Co. v. Cumberland, etc. Co.*, 16 Md. 456; 77 Am. Dec. 311.

⁶ *Northwestern Transportation Co.*

interested director, although expressly prohibited from voting as a director, may nevertheless vote as a shareholder — the resolution of confirmation being none the less effective because carried by his votes.¹ Of course, in any case — and particularly where the deciding votes are cast by interested parties — the confirmation by the shareholders may be challenged on the ground of fraud; and according to some authorities, as well as sound principle, the onus of disproving fraud rests upon the interested directors, especially where they control a majority of the shares.² If fraud exist, the confirmation will not be valid unless, rejecting the votes of the fraudulent shareholders, a majority in favor of confirmation still remains.³ Indeed, contracts in which a director has an interest are not *ultra vires*, and are voidable by the corporation only, hence a minority shareholder can never enjoin the execution of such contracts,

v. Beatty, 12 A. C. 589; *Burden v. Burden*, 159 N. Y. 287, 305-308; 54 N. E. 17; *Havens v. Hoyt*, 6 Jones Eq. (N. Car.) 115; *Barr v. Pittsburgh Plate Glass Co.*, 57 Fed. 86; 6 C. C. A. 260; *Hart v. Ogdensburg, etc. R. R. Co.*, 89 Hun (N. Y.) 316; 35 N. Y. Supp. 566; *Wallace v. Long Island R. R. Co.*, 12 Hun (N. Y.) 460; *Continental Ins. Co. v. New York, etc. R. R. Co.*, 187 N. Y. 225; 79 N. E. 1026.

See also *Nye v. Storer*, 168 Mass. 53; 46 N. E. 402; *Hill v. Nisbet*, 100 Ind. 341; *Metcalf v. American School Furniture Co.*, 122 Fed. 115; *Continental Ins. Co. v. New York, etc. R. R. Co.*, 103 N. Y. App. Div. 282; 93 N. Y. Supp. 27; *Teller v. Tonopah, etc. R. R.*, 155 Fed. 482.

But see *Cumberland Coal Co. v. Sherman*, 30 Barb. (N. Y.) 553, 577; *Pearson v. Concord R. R. Co.*, 62 N. H. 537; 13 Am. St. Rep. 590; *Cook v. Berlin Woolen Mill Co.*, 43 Wisc. 433; *Stanley v. Luse*, 36 Oreg. 25; 58 Pac. 75; *Knabe v. Ternot*, 16 La. Ann. 13; *Morgan v. King*, 27 Colo. 539; 63 Pac. 416; *Parsons v. Tacoma Smelting, etc. Co.*, 65 Pac. 765; 25 Wash. 492.

¹ *Northwestern Transportation Co. v. Beatty*, 12 A. C. 589; *East Pant Du, etc. Co. v. Merryweather*, 2 Hem. & Miller 254; *Green v. Felton* (Ind.), 84 N. E. 166.

See also *Ashurst's Appeal*, 60 Pa. St. 290 (headnote misleading); *Gamble v. Queen's County Water Co.*, 123 N. Y. 91, 97-99; 25 N. E. 201; 9 L. R. A. 527 (where a majority of the shareholders favored confirmation without counting the votes of the interested director); *Hodge v. U. S. Steel Corp.*, 64 N. J. Eq. 807, 813-818; 60 L. R. A. 742; 54 Atl. 1. Supra, § 1304-§ 1311.

But see *Wickersham v. Crittenden*, 110 Cal. 332, 334; 42 Pac. 893; *Chicago Hansom Cab Co. v. Yerkes*, 141 Ill. 320; 30 N. E. 667; 33 Am. St. Rep. 315; *Klein v. Independent Brewing Ass'n* (Ill.), 83 N. E. 434.

² *Meeker v. Winthrop Iron Co.*, 17 Fed. 48; *Booth v. Land Filling, etc. Co.*, 59 Atl. (N. J.) 767.

Cf. *Hancock v. Holbrook*, 40 La. Ann. 53; 3 So. 351.

See also supra, § 1304 et seq., § 1568.

³ *Atwood v. Merryweather*, 5 Ed. 464 n., 468.

unless they are actually fraudulent, if the shareholders are to have an opportunity to avoid them.¹

Failure to submit the contract to the shareholders for ratification does not render it void, it remains merely voidable by the company² — that is to say, it is still valid until disaffirmed by the corporation, and it is the company's right of disaffirmance that is tolled by ratification by the shareholders.

§ 1592. **Where interested Directors own Majority of the Shares.**

— A consequence of this power of the shareholders to ratify a contract made by an interested director is that where a director himself owns a majority of the shares, he may in any case force ratification of a contract in which he has an interest, unless there be actual fraud;³ and hence in such cases the rule that such contracts, whether in fact fraudulent or not, are always voidable by the company is illusory. Its place is taken by the rules of law applicable to one who holds the majority of the shares in a corporation.⁴ *A fortiori*, where the directors themselves own all the capital stock of the company, any contract which they may make for the corporation and in which they may have a private interest adverse to that of the company is nevertheless unimpeachable.⁵ Thus, where the directors of a railway company, who own all its shares, enter into an agreement with a contractor by which the latter agrees to build the road in con-

¹ *Burden v. Burden*, 159 N. Y. 287, 305-308; 54 N. E. 17; *Sellers v. Phoenix Iron Co.*, 13 Fed. 20 (headnote inadequate); *Bill v. Western Union Tel. Co.*, 16 Fed. 14, 19 (headnote inadequate).

Cf. *Hodge v. U. S. Steel Corp.*, 60 L. R. A. 742; 64 N. J. Eq. 807; 54 Atl. 1; *Urner v. Sollenberger*, 89 Md. 316; 43 Atl. 810.

But see *Graves v. Mono Lake, etc. Co.*, 81 Cal. 303, 320; 22 Pac. 665; *McLeod v. Lincoln Medical College*, 98 N. W. 672; 69 Nebr. 550; *Tenison v. Patton*, 67 S. W. 92, 95; 95 Tex. 284 (semble).

² *Urner v. Sollenberger*, 89 Md. 316; 43 Atl. 810.

But see *Mitchell v. United Box Board, etc. Co.* (N. J.), 66 Atl. 938 (where the court although recog-

nizing that the contract might be confirmed by the shareholders so as to be beyond the reach of attack by a minority shareholder, yet held that until so confirmed execution thereof should be enjoined at the instance of a single shareholder).

³ *Hill v. Gould*, 129 Mo. 106; 30 S. W. 181; *Burden v. Burden*, 159 N. Y. 287, 305-308; 54 N. E. 17, are cases of this sort.

⁴ Cf. *Hayden v. Official Hotel, etc. Co.*, 42 Fed. 875.

See *supra*, § 1304 et seq.

⁵ *Kellerman v. Maier*, 116 Cal. 416, 422-423 (headnote inadequate); 48 Pac. 377.

Cf. *Givens v. Gans*, 91 N. Y. App. Div. 37; 86 N. Y. Supp. 450; 181 N. Y. 538; 73 N. E. 1124.

sideration of a transfer of all the stock and bonds of the corporation, he at the same time promising to pay the directors one half of the net profits, the contract is binding upon the company.¹

§ 1593. **Confirmation by disinterested Board of Directors.** — Where the transaction is confirmed by the board of directors after the interested director goes out of office, the corporation will be bound. But such ratification or confirmation, like similar action by the shareholders, to be effectual, must be made with knowledge that the transaction might be avoided. Thus, an alteration in some of the terms of the contract by the new board will not render the contract binding.² Wherever the doctrine prevails that a contract between a director and his company is valid if his colleagues and not he himself act for the company in the matter, it necessarily follows that a contract made by a director with himself may be ratified by the disinterested members of the board even while the interested director continues in office.

§ 1594. **Only the Corporation entitled to avoid the Transaction — Rights of Creditors, etc.** — As has been said above, contracts between a director and his company are not nullities, but are merely voidable in equity at the option of the corporation.³ The contract is not void unless confirmed, but is binding unless disaffirmed.⁴ Hence, such contracts cannot be avoided by anybody except the company. For instance, where a promissory note payable to the order of a corporation is endorsed to a director, the maker of the note when sued by the endorsee cannot question the validity of the transfer by reason of the endorsee's fiduciary relation towards the company.⁵ We have already seen that such contracts cannot be avoided by a minority shareholder.⁶

¹ *McCracken v. Robinson*, 57 Fed. 375; 6 C. C. A. 400.

See also *Roy & Co. v. Scott*, *Hartley & Co.*, 11 Wash. 399 (head-note misleading); 39 Pac. 679.

² *Aberdeen Ry. Co. v. Blaikie*, 1 Macq. H. L. 461, 475.

Cf. *Northumberland Avenue Hotel Co.*, 33 Ch. D. 16.

³ *Supra*, § 1570.

⁴ *Urner v. Sollenberger*, 89 Md. 316; 43 Atl. 810.

⁵ *Klein v. Funk*, 84 N. W. 460; 82 Minn. 3.

⁶ *Supra*, § 1591.

So, too, a sale of corporate property to the directors cannot be treated as a nullity, or annulled, by individual creditors of the corporation.¹ Nor can it be avoided by an assignee or lessee of the company's property and contracts.² Of course, a receiver or official liquidator, as representative of all parties, — corporation, shareholders, and creditors, — may avoid the contract,³ but the individual creditors have no such right unless the contract was executed for the purpose, or has the necessary effect, of defrauding them.

The law governing attempts by directors of a concern on the point of insolvency to secure a preference for their own claims against the company relates to the subject of winding-up and dissolution, and is hardly pertinent here. Suffice it to say that, preferences of that sort may, on principle, it would seem, be avoided by the receiver or liquidator without resort to any "trust-fund theory," or to any bankruptcy law invalidating fraudulent preferences, upon the simple principle that all dealings between a corporation and its directors are voidable by the company or its receivers.⁴ Indeed, it would seem that such preferences may be set aside by individual creditors without resorting to any "trust-fund theory" or bankrupt act, upon the ground that such preferences are fraudulent at common law or under the Statute of Elizabeth. For, at common law, a debtor

¹ *O'Conner Mining, etc. Co. v. Ill. 162; 22 N. E. 464; 17 Am. St. Coosa Furnace Co.*, 95 Ala. 614; 10 So. 290; 36 Am. St. Rep. 251; *Salt-marsh v. Spaulding*, 147 Mass. 224; 17 N. E. 316; *Inglehart v. Thousand Island Hotel Co.*, 109 N. Y. 454; 17 N. E. 358; *Buell v. Buckingham, etc. Co.*, 16 Iowa 284 (headnote misleading); 85 Am. Dec. 516; *Foster v. Mullanphy, etc. Co.*, 92 Mo. 79; 4 S. W. 260; *Graham v. Railroad Co.*, 102 U. S. 148; *Ready v. Smith*, 170 Mo. 163; 70 S. W. 484; *Sanford Fork & Tool Co. v. Howe, Brown & Co.*, 157 U. S. 312; 15 Sup. Ct. 621.

Cf. *Rogers v. Pell*, 154 N. Y. 518; 49 N. E. 75; *Sweeny v. Sugar Co.*, 30 W. Va. 443; 4 S. E. 431; 8 Am. St. Rep. 88; *Cole v. Millerton Iron Co.*, 59 Hun (N. Y.) 217; 13 N. Y. Supp. 851; *Beach v. Miller*, 130

Ill. 162; 22 N. E. 464; 17 Am. St. Rep. 291; Mullanphy Savings Bank v. Schott, 135 Ill. 655; 26 N. E. 640; 25 Am. St. Rep. 401; *Hope v. Valley City Salt Co.*, 25 W. Va. 789; *Wilmott v. London Celluloid Co.*, 34 Ch. D. 147; *Anglo-American Provision Co. v. Davis Provision Co.*, 112 Fed. 574 (transfer of chose in action to director prevents set-off by debtor of a cross-claim owing by company); *Marsters v. Umpqua Valley Oil Co.* (Oreg.), 90 Pac. 151.

But see *Fishel v. Goddard*, 69 Pac. 607; 30 Colo. 147.

² *Stewart v. Lehigh Valley R. R. Co.*, 38 N. J. Law 505, 524.

³ *Hayes v. Pierson*, 65 N. J. Eq. 353; 45 Atl. 1091; 58 Atl. 728.

⁴ See *Haywood v. Lincoln Lumber Co.*, 64 Wisc. 639; 26 N. W. 184.

might prefer such of his creditors as he chose, but could not, under the guise of preferring particular creditors, really prefer himself; and a logical result of the application of this rule to corporations is that preferences of the claims of directors, who for so many purposes are deemed to be equivalent to the company itself, are voidable by other creditors as attempts by the corporation to prefer itself.¹

§ 1595. **Necessity for Return of Consideration by Company exercising Right of Rescission.**—Upon the avoidance by the company of any contract in which a director is interested, clearly the consideration must be returned, and, generally, so far as possible, the opposite party must be restored to his original status.² Thus, where a construction company has made a contract with a railway corporation, in which some of its members are directors, for the construction of the latter's road, the railway may rescind the contract, but on so doing must compensate the construction company for all the services which it actually rendered thereunder.³

§ 1596—§ 1603. PARTICULAR TRANSACTIONS.

§ 1596. **Loans by Directors to the Company.**—Where a director has made a loan or advance of money to the corporation,

¹ *Howe v. Sanford Fork & Tool Co.*, 44 Fed. 231; *Lippincott v. Gas, etc. Co.*, 131 Cal. 656; 63 Pac. Shaw Carriage Co., 25 Fed. 577. 1011; *Copeland v. Johnson Mfg. Co.*, 47 Hun (N. Y.) 235; *Griffith v. Blackwater Boom & Lumber Co.*, 46 W. Va. 56; 33 S. E. 125; s. c. (on a second appeal), 48 S. E. 442; 55 W. Va. 604; 69 L. R. A. 124.

² *Great Luxembourg Ry. Co. v. Magnay*, 25 Beav. 586; *Barr v. New York, etc. R. R. Co.*, 125 N. Y. 263; 26 N. E. 145.

Cf. *Gardner v. Butler*, 30 N. J. Eq. 702 (headnote inadequate); *Oliver v. Rahway Ice Co.*, 54 Atl. 460; 64 N. J. Eq. 596; *Wyman v. Bowman*, 127 Fed. 257; 62 C. C. A. 189.

It has been held that this rule does not apply where the director against whom rescission is asked was guilty of actual fraud. *Gerry v. Bismark Bank*, 19 Mont. 191; 47 Pac. 810. Cf. *Harrison v. Thomas*, 112 Fed. 22; 50 C. C. A. 98. *Sed quære de hoc.*

³ *Thomas v. Brownville, etc. R. R. Co.*, 109 U. S. 522; 3 Sup. Ct. 315.

See also, as illustrations of the

same principle, *Sims v. Petaluma* 1011; *Copeland v. Johnson Mfg. Co.*, 47 Hun (N. Y.) 235; *Griffith v. Blackwater Boom & Lumber Co.*, 46 W. Va. 56; 33 S. E. 125; s. c. (on a second appeal), 48 S. E. 442; 55 W. Va. 604; 69 L. R. A. 124.

But see *Branch of the Bank v. Collins*, 7 Ala. 95; *Harrison v. Thomas*, 112 Fed. 22; 50 C. C. A. 98 (holding that the burden is on the director to show precisely how much the services rendered by him were really worth); *Greathouse v. Martin* (Tex.), 94 S. W. 322 (similar point).

Cf. *Millsaps v. Chapman*, 76 Miss. 942; 26 So. 369; 71 Am. St. Rep. 547; *Pauly v. Pauly*, 107 Cal. 8; 40 Pac. 29; 48 Am. St. Rep. 98; *Oliver v. Rahway Ice Co.*, 54 Atl. 460; 64 N. J. Eq. 596.

his rights are very much the same, under general doctrines of equity, whether the contract be affirmed or avoided: in either case his money must be returned with interest.¹ If the express contract is voidable by the corporation, one might argue that, upon its avoidance, any special rights such as would be conferred by collateral securities or mortgage bonds should go by the board,² and that the lender should be obliged to take his place among the general creditors. In numerous cases, however, the lending director has been allowed the benefit of the security;³ and indeed, it would seem that except where the security is given after the loan is made,⁴ the company should not be allowed to rescind the contract of hypothecation without first restoring the consideration — that is to say, without paying the debt, — so that in effect the director would get the benefit of the security.⁵ Some cases proceed on the bald ground that directors are permitted to lend money to their company upon such special terms as may be agreed upon;⁶ but this rule, which puts it in the

¹ But cf. *Elliott v. Farmers' Bank* (W. Va.), 57 S. E. 242 (where the claims of directors who had wrecked the company by neglect and mismanagement were in dissolution proceedings postponed to the claims of other creditors).

² *Koehler v. Black River Falls Iron Co.*, 2 Black 715; *Scott v. Farmers', etc. Nat. Bank*, 75 S. W. 7, 9; 97 Tex. 31.

Cf. *Graves v. Mono Lake, etc. Co.*, 81 Cal. 303; 22 Pac. 665; *Davis v. Rock Creek, etc. Co.*, 55 Cal. 359; 36 Am. Rep. 40.

³ *Campbell's Case*, 4 Ch. D. 470; *General Auction, etc. Co. v. Smith* (1891), 3 Ch. 432 (where, however, the question was not discussed); *Bensiek v. Thomas*, 66 Fed. 104 (headnote inadequate); 13 C. C. A. 457; *St. Joe, etc. Mining Co. v. First Nat. Bank*, 10 Colo. App. 339; 50 Pac. 1055; *Harts v. Brown*, 77 Ill. 226; *Illinois Steel Co. v. O'Donnell*, 156 Ill. 624; 41 N. E. 185; 47 Am. St. Rep. 245; 31 L. R. A. 265; 1055; *Harts v. Brown*, 77 Ill. 226; *Hopson v. Aetna Axle, etc. Co.*, 50 Conn. 597; *Manufacturing Co. v.*

Bradley, 105 U. S. 175; *Gorder v. Plattsmouth Canning Co.*, 36 Nebr. 548; 54 N. W. 830; *Jones v. Hale*, 32 Oreg. 465; 52 Pac. 311; *Webster v. Ypsilanti Canning Co.* (Mich.), 113 N. W. 7; *Schnittger v. Old Home, etc. Co.*, 144 Cal. 603; 78 Pac. 9; *Wyman v. Bowman*, 127 Fed. 257; 62 C. C. A. 189.

Cf. *Pyle Works No. 2* (1891), 1 Ch. 173; *New Memphis Gaslight Co. Cases*, 105 Tenn. 268; 60 S. W. 206; 80 Am. St. Rep. 880.

⁴ Cf. *Richardson v. Green*, 133 U. S. 30.

⁵ *Duncomb v. N. Y., etc. R. R. Co.*, 84 N. Y. 190, with which compare s. c. 88 N. Y. 1.

Cf. also *Charter Gas, etc. Co. v. Charter*, 47 Ill. App. 36; *Kinsman v. Fisk*, 83 Hun (N. Y.) 494; 31 N. Y. Supp. 1045.

⁶ *Patterson v. Portland Smelting Co.*, 35 Oreg. 96; 56 Pac. 407; *St. Joe, etc. Mining Co. v. First Nat. Bank*, 10 Colo. App. 339; 50 Pac. 1055; *Harts v. Brown*, 77 Ill. 226; *Schufeldt v. Smith*, 131 Mo. 280; 31 S. W. 1039; 52 Am. St. Rep.

power of directors to act the part of a Shylock towards the company and attach all manner of burdensome conditions to the loan, such as (usury laws apart) excessive rates of interest,¹ is hardly to be commended. Of course, directors are in no sense under a duty to make loans to the company.² Some statutes expressly declaring contracts between directors and the corporation to be void have been construed, by a rather harsh construction, to prevent a director from recovering money lent to the company;³ but even under that construction of such statutes, it is said that the director may recover all sums actually expended by the company in its business.⁴ It has been held that a statutory liability of shareholders to creditors cannot be availed of by directors who may lend money to the corporation, since statutes imposing such liability are intended for the benefit of outside creditors, and are "not intended for the protection of the debt-makers, directors who constitute themselves creditors of the corporation and thus attempt to unload their burden upon stockholders whose interests were committed to their hands."⁵

§ 1597. **Subscription by Directors to the Company's Shares or Bonds.** — It would seem, on principle, that directors who are charged with the duty of disposing of unissued shares, bonds, or debentures of the company to the best advantage should not be allowed to subscribe for them on their own behalf.⁶ The contract

628; 29 L. R. A. 830; *Preston v. Loughran*, 58 Hun (N. Y.) 210; 12 N. Y. Supp. 313; *Gorder v. Platts-*

mouth Canning Co., 36 Nebr. 548; 54 N. W. 830; *College Park Electric Belt Line v. Ide & Son*, 15 Tex. Civ. App. 273; 40 S. W. 64; *Wyman v. Bowman*, 127 Fed. 257, 273; 62 C. C. A. 189; *Law v. Fuller* (Pa.), 66 Atl. 754.

Cf. *Buck v. Troy Aqueduct Co.* (Vt.), 56 Atl. 285; 76 Vt. 75 (where a director acted as agent for the lender in negotiating the loan); *Blake v. Ray* (Ky.), 62 S. W. 531 (where the company assigned a promissory note to the director in payment of the loan); *Shively v. Eureka, etc. Mining Co.* (Cal.), 89 Pac. 1073.

¹ See *Kroegher v. Calivada Colo-*

nization Co., 119 Fed. 641, 651-652; 56 C. C. A. 257.

² *Teller v. Tonopah, etc. R. R.*, 155 Fed. 482, 483-484 (headnote inadequate).

³ *Teversham v. Camerons, etc. Co.*, 3 DeG. & Sm. 296; *Baker's Case*, 1 Dr. & Sm. 55.

⁴ *Baker's Case*, 1 Dr. & Sm. 55, 66, 67.

⁵ *McDowall v. Sheehan*, 129 N. Y. 200, 206; 29 N. E. 299.

Cf. *Elliott v. Farmers' Bank* (W. Va.), 57 S. E. 242.

⁶ *Arkansas Valley Agricultural Soc. v. Eichholtz*, 45 Kans. 164; 25 Pac. 613 (where, however, the transaction was tainted with actual fraud); *Mosher v. Sinnott*, 79 Pac. (Colo.) 742. Cf. *Ayre v. Skelsey's Adamant Cement Co.*, 21 Times

of subscription does not differ from any other contract between directors and their company.¹ The only reason for reaching a different result is that a subscription to the company's shares or bonds is often a matter of accommodation to the company rather than of privilege to the director. Hence it has been held that, where directors are offering bonds or debentures to the public at less than par, they may lawfully issue them to themselves at the same rate.² On principle, it would seem, however, that the consent of the shareholders, which is generally easy to obtain, should be secured, if a director's subscription to the company's securities is desired to be made impregnable. At any rate, an issue of shares by directors to themselves or their friends for the purpose of keeping control of the company is voidable.³

§ 1598-§ 1600. *Resolutions of Directors for Payment of Compensation to themselves.*

§ 1598. **In general.** — As explained above, directors are not ordinarily entitled to any salary or compensation for their services, unless the company's regulations provide therefor.⁴ From the principles stated above, the deduction is inevitable that they have no power to vote themselves compensation to which they would not otherwise be entitled, either by way of gratuity for past services or by way of fixing a salary to attach to the office for the future.⁵ It makes no difference that the

L. R. 464 (sustaining with some hesitation a subscription by directors to preferred shares where four years had elapsed after the issue of the shares before the transaction was attacked and where no actual fraud was proved).

¹ But as to loans by a director to his company, see last section.

² *Campbell's Case*, 4 Ch. D. 470. Cf. *Combination Trust Co. v. Weed*, 2 Fed. 24.

³ *Luther v. C. J. Luther Co.*, 94 N. W. 69; 118 Wisc. 112; 99 Am. St. Rep. 977.

⁴ *Supra*, § 1490.

⁵ *Bodega Co.* (1904), 1 Ch. 276, 285-286 (headnote inadequate); *Normandy v. Ind, Coope & Co.* (1908), 1 Ch. 84; *Jones v. Morrison*, 31 Minn. 140; 16 N. W. 854; *Maux Ferry, etc. Co. v. Branegan*, 40 Ind. 361; *Loan Ass'n v. Stonemetz*, 29 Pa. St. 534; *Butts v. Wood*, 37 N. Y. 317; *Graves v. Mono Lake, etc. Co.*, 81 Cal. 302; 22 Pac. 665; *Doe v. Northwestern, etc. Co.*, 78 Fed. 62; *Marshall v. Industrial Federation*, 84 N. Y. Supp. 866; 14 N. Y. Ann. Cas. 100; *Quintance v. Farmers' Mut. Aid Ass'n*, 77 S. W. 1121; 25 Ky. Law Rep. 1379; *Grafner v.*

salary allowed them, if any, is inadequate.¹ Consequently, the directors have no power to pay themselves the income tax which is payable on the amount of their salaries as fixed by the regulations of the company.² On the same principle, directors cannot on a sale of the company's assets appropriate to themselves a sum of money in compensation for their loss of office.³ The action of directors in voting compensation to themselves may, however, be ratified and confirmed by the shareholders even where a statute provides that no compensation shall be paid them unless allowed by the shareholders.⁴ A provision in the company's regulations that the "salaries of officers and employees shall be fixed by the board of directors" does not enable the directors to fix their own salaries.⁵ The extent to which the payment of gratuities for past services is *ultra vires* of the corporation, and so beyond the powers of a majority of the shareholders, has been elsewhere considered.⁶

§ 1599. **Appointing Members of the Board to Remunerative Offices.** — Whether or not directors may appoint one of their number to a salaried office in the corporation may be somewhat doubtful. Of course, in any jurisdiction where disinterested directors may on behalf of the company enter into a contract with a co-director who acts solely on his own behalf, a competent quorum of disinterested directors may appoint a colleague to office and agree to pay him a salary.⁷ But inasmuch as the

Pittsburg, etc. Ry. Co., 207 Pa. St. 217; 56 Atl. 426 (where shares issued by directors to themselves as compensation for their services were held invalid in the hands of a purchaser with notice); *Wood v. Lost Lake Mfg. Co.*, 23 Oreg. 20; 23 Pac. 848; 37 Am. St. Rep. 651; *Hingston v. Montgomery (Mo.)*, 97 S. W. 202.

Cf. *Lillard v. Oil, Paint & Drug Co. (N. J.)*, 56 Atl. 254.

The contrary opinion expressed in *Hedges v. Paquett*, 3 Oreg. 77, was *obiter dictum*, the point actually decided being that a minority shareholder could not complain.

¹ *York & North Midland Ry. v. Hudson*, 16 Beav. 485.

² *Boschoek Proprietary Co. v. Fuke* (1906), 1 Ch. 148.

³ *Gaskell v. Chambers (No. 3)*, 26 Beav. 360.

But see *General Exchange Bank v. Horner*, 9 Eq. 480.

⁴ *Schickell v. Berryville Land, etc. Co.*, 37 S. E. 813; 99 Va. 88.

⁵ *Schoening v. Schwenk*, 112 Iowa 733 (headnote inadequate); 84 N. W. 916.

⁶ *Supra*, § 87-§ 89, especially § 88.

⁷ *St. Louis, etc. R. R. Co. v. Tiernan*, 37 Kans. 606; 15 Pac. 544; *Funsten v. Funsten Co.*, 67 Mo. App. 559; *Stewart v. St. Louis, etc. R. Co.*, 41 Fed. 736; *Bagaley v. Pittsburgh, etc. Co.*, 146 Pa. St. 478; 23 Atl. 837; *Stevenson v. Dubuque, etc. Mining Co.*, 34 Iowa 577, 582-583; *Clark v. American Coal Co.*, 86 Iowa

directors are often the persons best qualified to fill the important offices, any rule of law that would prevent them from occupying those positions would be unfortunate; and accordingly even in England it was held that persons acting as directors might designate one of their number as a paid manager of the company,¹ and this decision would probably be concurred in by any courts that adhere to the English rule on the general subject.² But according to the English doctrine the only power of giving a gratuity for past services to a director who has filled some other office in the company resides in the shareholders and not in the co-directors.³ To permit directors to appoint a colleague to an established office to which a salary is already regularly attached may be right enough; but to allow them to create an office or fix its salary, and simultaneously appoint a co-director to fill it, is a privilege more open to abuse.⁴ To vote a salary to a co-director for past services as an officer is still more objectionable.⁵ At all events, directors cannot evade the rule

436; 53 N. W. 291; 17 L. R. A. 557; *Waite v. Windham, etc. Co.*, 37 Vt. 608; *Fort Payne Rolling Mill v. Hill*, 174 Mass. 224; 54 N. E. 532; *Stacy v. Cherokee, etc. Works*, 70 S. Car. 178; 49 S. E. 223; *Fillebrown v. Hayward*, 190 Mass. 472; 77 N. E. 45.

Cf. *Hook v. Financier Co.*, 99 N. Y. App. Div. 186; 90 N. Y. Supp. 1012; *Bevier, etc. Coal Co. v. Watson*, 80 S. W. 287; 107 Mo. App. 451.

But see *Mallory v. Mallory Wheeler Co.*, 61 Conn. 131; 23 Atl. 708.

In California a director who held the offices of superintendent of the company's business, treasurer, etc., was allowed to recover the salary attaching to those offices, although the holding of a plurality of offices was a violation of the company's regulations.

¹ *Eales v. Cumberland Black Lead Mine Co.*, 6 H. & N. 481.

² *George Newman & Co.* (1895), 1 Ch. 674.

But see *Alexander's Timber Co.*, 70 L. J. Ch. 767; *Branch of the*

Bank v. Collins, 7 Ala. 95; *Kelsey v. Sargent*, 40 Hun (N. Y.) 150; *Normandy v. Ind. Coope & Co.* (1908), 1 Ch. 84.

³ *Holder v. Lafayette, etc. Ry. Co.*, 71 Ill. 106; 22 Am. Rep. 89. See also cases cited supra, p. 1319, n. 5.

But cf. *First Nat. Bank v. Drake*, 29 Kans. 311, 330; 44 Am. Rep. 646.

As to the power to issue a promissory note in payment for services rendered by a director under an agreement that he should be paid a reasonable sum, see *Nat. Loan, etc. Co. v. Rockland Co.*, 94 Fed. 335; 36 C. C. A. 370.

⁴ *Adams v. Burke*, 201 Ill. 395; 66 N. E. 235; *Bergdoll v. Bergdoll Brewing Co.*, 10 Pa. Dist. Rep. 173; *Raynolds v. Diamond Mills Paper Co.* (N. J.), 60 Atl. 941 (headnote misleading).

Cf. *Wood v. Lost Lake Mfg. Co.*, 23 Oreg. 20; 23 Pac. 848; 37 Am. St. Rep. 651; *Williams v. Little Falls, etc. Power Co.* (Minn.), 108 N. W. 289.

⁵ *Monmouth Investment Co. v.*

which prohibits them from voting compensation to themselves by creating a sinecure salaried office to which no duties are attached other than those that devolve upon all directors and appointing one of their number as the incumbent thereof.¹ Of course, a resolution appointing a director to a paid office or fixing his salary as such officer is voidable if carried by his vote.²

§ 1600. **Compensation for Extra Services.** — Often the question arises as to the rights of a director who has never been appointed to a recognized office but who has performed extra services for the company under a special contract with his co-directors for compensation at a stipulated rate. In such cases, the English courts and those American authorities that agree with them must hold that the special contract is unenforceable, remitting the director to his rights *quasi ex contractu*.³ The courts which affirm the distinctively American doctrine, of course, encounter no difficulty in holding that the special contract, if free from all taint of fraud, is enforceable.⁴ Clearly, the special contract is everywhere voidable if the resolution to make it was carried by the votes of interested directors.⁵ Where the director is entitled to compensation for services rendered before becoming

Means, 151 Fed. 159; 80 C. C. A. 527.

¹ *Brown v. Republican, etc. Silver Mines*, 17 Colo. 421, 424 (headnote inadequate); 30 Pac. 66; 16 L. R. A. 426; *Fritze v. Equitable Bldg., etc. Soc.*, 186 Ill. 183; 57 N. E. 873.

Cf. *Loan Ass'n v. Stonemetz*, 29 Pa. St. 534; *Branch of the Bank v. Collins*, 7 Ala. 95.

² *Jones v. Morrison*, 31 Minn. 140; 16 N. W. 854; *Mallory v. Mallory Wheeler Co.*, 61 Conn. 131; 23 Atl. 708; *Davis Mill Co. v. Bennett*, 39 Mo. App. 460; *Martin v. Santa Cruz, etc. Co.*, 36 Pac. 36; 4 Ariz. 171; *Ward v. Davidson*, 89 Mo. 445; 1 S. W. 846; *Davis v. Thomas & Davis Co.*, 63 N. J. Eq. 572; 52 Atl. 717; *Bergdoll v. Bergdoll Brewing Co.*, 10 Pa. Dist. Rep. 173; *Jacobson v. Brooklyn Lumber Co.*, 184 N. Y. 152; 76 N. E. 1075 (where a minority shareholder was

allowed to maintain bill to recover back the salary); *Schaffhauser v. Arnholt, etc. Brewing Co. (Pa.)*, 67 Atl. 417 (similar to last case); *Paxton v. Heron (Colo.)*, 92 Pac. 15.

Cf. *Wickersham v. Crittenden*, 93 Cal. 17, 32; 28 Pac. 788; *McConnell v. Combination Mining, etc. Co.*, 30 Mont. 239; 76 Pac. 194; 104 Am. St. Rep. 703; 31 Mont. 563; 79 Pac. 248; *Steel v. Gold, etc. Co. (Colo.)*, 95 Pac. 349.

³ As to which, see *supra*, § 1503 et seq.

Cf. *Davis v. Thomas & Davis Co.*, 63 N. J. Eq. 572; 52 Atl. 717.

⁴ Cf. *Beach v. Stouffer*, 84 Mo. App. 395.

⁵ Cf. *Raynolds v. Diamond Mills Paper Co. (N. J.)*, 60 Atl. 941 (headnote misleading); *Greathouse v. Martin (Tex.)*, 94 S. W. 322; *Camden Land Co. v. Lewis*, 101 Me. 78, 97; 63 Atl. 523.

a member of the board, or for extra services while a director, a resolution of the board, not carried by his own vote, appropriating stock in payment of his claim, has been allowed to stand, although the stock subsequently increases in value.¹

§ 1601. **Suits by Directors against the Company.** — The question sometimes arises as to the right of a director to enforce by action a claim of his against the corporation. The objection to his doing so is that both sides of the litigation would be in a measure under his control; and in those jurisdictions in which a director is not permitted to have dealings with the company even although the corporation is represented in the matter altogether by other directors, the objection would seem to be very formidable. But even in those jurisdictions, and *a fortiori* elsewhere, the decisions seem to be that a judgment obtained by a director against the company is unimpeachable if entire good faith in its obtention be proved;² and, this being true, it would seem clear that the director may enforce the judgment by levying on the property of the corporation.³ So, a director who is a creditor of the corporation may foreclose any valid mortgage

¹ *Rosehill Cemetery Co. v. Dempster*, 79 N. E. 276; 223 Ill. 567.

² In addition to cases cited *infra* see *Stratton v. Allen*, 13 N. J. Eq. 229, where the judgment was entered by confession and to be compared with *Wilmott v. London Celluloid Co.*, 34 Ch. D. 147; *Manley v. Mayer*, 75 Pac. 550; 68 Kans. 377 (judgment by confession in favor of officer at most voidable and not altogether void); *Rollins v. Shaver, Wagon, etc. Co.*, 80 Iowa 380; 45 N. W. 1037; 20 Am. St. Rep. 427 (where a director was allowed to attach the company's property); *First Nat. Bank v. Wyoming Valley Ice Co.*, 136 Fed. 466 (petition by directors to throw company into bankruptcy); *Off v. Jack*, 204 Ill. 79; 68 N. E. 427 (where burden of proving actual fraud was held to rest on the party attacking the

validity of the judgment); *Michel v. Betz*, 108 N. Y. App. Div. 241; 95 N. Y. Supp. 844; *Miller v. Oregon City, etc. Mfg. Co.*, 3 Oreg. 24.

But see *Gund v. Ballard* (Nebr.), 103 N. W. 309 (where a judgment in a suit by a corporation against a director was set aside without proof of actual fraud).

³ *Hoyle v. Plattsburgh, etc. R. R. Co.*, 54 N. Y. 314; *Hoffman v. Reichert*, 147 Ill. 274, 280; 35 N. E. 527; 37 Am. St. Rep. 219 (semble); *Relender v. Riggs*, 79 Pac. (Colo.) 328; *Off v. Jack*, 204 Ill. 79; 68 N. E. 427; *Snediker v. Ayers*, 146 Cal. 407; 80 Pac. 511; *Marr v. Marr* (N. J.), 66 Atl. 182.

Cf. *Salina Nat. Bank v. Prescott*, 60 Kans. 490; 57 Pac. 121; *Coombs v. Barker*, 31 Mont. 526; 79 Pac. 1; *Kittel v. Augusta, etc. R. R. Co.*, 84 Fed. 386; 28 C. C. A. 437.

which he may hold on its property.¹ So, too, a decree of foreclosure entered against a corporation by the trustees of a mortgage deed of trust securing its bonds is not impeachable merely because the trustees were also directors in the defendant company, and because the bondholder at whose instance the suit was instituted was in control of the corporation.² *A fortiori* a judgment entered against one corporation at the suit of another is not impeachable merely because the two companies had common directors.³ Nor is a decree against a company voidable because the attorney who represented an opposing party in the litigation was a director in the company.⁴ On the other hand, service of process against a corporation on an officer who was also acting as agent or attorney for the plaintiff in the same transaction may be set aside in equity.⁵ Where a director purchases with his own money a claim against the company which he was deputed to buy on its behalf, he holds the mortgage as trustee for the company subject to a right of reimbursement for his expenditure,⁶ and his rights, it has been held, are not augmented by reducing the claim to judgment.⁷

A director is not precluded from suing the company for damages on account of a fraudulent overissue of capital by the transfer agent although the fraud was rendered possible by the directors' inattention to duty.⁸

¹ *Twin-Lick Oil Co. v. Marbury, Co.*, 134 U. S. 688; 10 Sup. Ct. 91 U. S. 587; *Hallam v. Indianola Hotel Co.*, 56 Iowa 178; 9 N. W. 111 (semble); *Preston v. Loughran*, 58 Hun (N. Y.) 210; 12 N. Y. Supp. 313; *McMurtry v. Montgomery Masonic Temple Co.*, 86 Ky. 206; 5 S. W. 570; *Rylander v. Sheffield*, 108 Ga. 111; 34 S. E. 348.

Cf. *Michel v. Betz*, 108 N. Y. App. Div. 241; 95 N. Y. Supp. 844.

² *Salina Nat. Bank v. Prescott*, 60 Kans. 490; 57 Pac. 121.

³ *Leavenworth v. Chicago, etc. Ry. Co.*, 134 U. S. 688, 705; 10 Sup. Ct. 708.

⁴ *Fox v. Robbins* (Tex.), 62 S. W. 815; *Fox v. Robbins* (Tex.), 70 S. W. 597.

⁵ See infra, § 1620. Cf. § 1623.

⁶ *Kroegher v. Calivada Navigation Co.*, 119 Fed. 641; 56 C. C. A. 257.

⁷ *N. Y., etc. R. R. Co. v. Schuyler*, 34 N. Y. 30, 89-90.

⁸ *Leavenworth v. Chicago, etc. Ry.*

§ 1602-§ 1603. *Exceptional Cases in which interested Directors may properly act.*

§ 1602. In general — Questions in which Directors have a private adverse Interest thrust upon them for Decision without their Choice. — The foregoing pages have discussed the rights and liabilities of directors where they voluntarily involve the company in transactions in which they, or some of them, have an individual interest; but frequently in the ordinary course of business questions are thrust upon directors in the decision of which they have a personal interest perhaps conflicting with that of the company. What are they to do in such cases? Their position is certainly a delicate one and fraught with danger to the company. Nevertheless, the situation is not of their own choosing, and therefore they cannot be deemed culpable. "The rule really is, that no one who has a duty to perform shall place himself in a situation to have his interests conflicting with that duty;"¹ and hence the reason of the rule is largely lacking where the director does not "place himself" in such a situation, but where he is placed there by Providence.

Accordingly, it has been held in some such cases that an interested director may act in conjunction with his disinterested colleagues.² Thus, where transfers of shares require the assent of the directors, a transfer is not invalidated because directors interested either as transferors or transferees took part in approving the transfer.³ Nevertheless, it is submitted that where some only of the directors are affected with a personal interest of that sort, their safest course is to refrain from voting, and to commit the matter entirely to their impartial associates.

¹ *Broughton v. Broughton*, 5 De G. the officers of a corporation to themselves, see *supra*, § 919.
M. & G. 160, 164, per Lord Cranworth.

² Cf. *Hedges v. Paquett*, 3 Oreg. 77; *Kidd v. New Hampshire Trust Co.* (N. H.), 66 Atl. 127 (holding that directors nominated by a third person are not disqualified to act in respect to matters pending between him and the company at the time of their election).

As to share-certificates issued by

³ *Bush's Case*, 6 Ch. 246 (affirmed *sub nom. Murray v. Bush*, L. R. 6 H. L. 37).

Cf. *Adamson's Case*, 18 Eq. 670 (headnote inadequate); *Ex parte Bentley*, 12 Ch. D. 850; *Ex parte Littledale*, 9 Ch. 257.

Where all the directors are interested adversely to the corporation, it seems clear that *ex necessitate rei* they must have power to act. Otherwise, the business of the corporation could not be carried on.¹ Indeed, the powers of directors are always capable of being used for their own advantage rather than for that of the shareholders at large; yet this circumstance does not incapacitate them from acting. For instance, directors might make calls upon the shares at such times as would be most convenient for themselves as shareholders, rather than at such times as would best subserve the interest of the company at large; yet of course they are not on that account incapacitated from determining when to make a call. Whenever, by such an awkward combination of circumstances, directors are placed in a position where their individual interest conflicts with the company's, they may not only legally act, but their liability will be measured by the same rather easy standard as in other cases; that is, they will not be liable (so long as their actions are *intra vires*) in the absence of fraud or "gross" negligence.² If they honestly act for what they believe to be the interest of the company, they are not liable merely because they were also promoting their own interests.³ Nevertheless, it has been held that a resolution of directors postponing the time for a general meeting of the company, with the result of prolonging their own terms of office is invalid⁴ — a conclusion which is to be justified not by the mere fact that the directors had a private interest but by the further fact that they allowed themselves to be swayed by that interest.

§ 1603. **Limits of this Doctrine.** — The right of interested directors to act under the peculiar circumstances mentioned in the last paragraph must be carefully confined to cases in which they accept no personal benefit from the transaction other than

¹ But see *Pearson v. Concord R. R. Co.*, 62 N. H. 537; 13 Am. St. Rep. 590, where the court appointed a "trustee" to attend to certain affairs of the company in which the directors had private adverse interests.

² *Lagunas Nitrate Co. v. Lagunas Syndicate* (1899), 2 Ch. 392, 435.

³ *Hirsche v. Sims* (1894), A. C. 654, 660, 661.

⁴ *Curtis v. McCullough*, 3 Nev.

202, 225-227; *Elkins v. Camden, etc. R. R. Co.*, 36 N. J. Eq. 467; *Mottu v. Primrose*, 23 Md. 482.

Cf. *Pond v. Vermont, etc. R. R. Co.*, 19 Fed. Cas. 968, 975-976.

As to the frustration of attempts of directors to perpetuate or prolong their own control, see further *Robotham v. Prudential Ins. Co.*, 64 N. J. Eq. 673; 53 Atl. 842.

the advantage, if any, necessarily accruing to them on account of the situation in which they find themselves placed. If they do accept any such additional benefit, their action may be avoided at the election of the company. For example, while in general a power vested in directors to approve or reject a transfer of shares may be exercised although they may be personally interested either as transferors or transferees, yet if a sum of money is paid by a transferee of shares to induce the directors to approve a transfer, the transferor may still, at the option of the company, be held liable as shareholder.¹

Moreover, it is clear that the directors must not permit themselves to be influenced by their private interest in the transaction. They must act with an eye single to the welfare of the company; and although the law allows them, in these exceptional cases, to act notwithstanding their private interest, yet it does not suffer them to act for the purpose of promoting their own interests, but will jealously scrutinize the transaction for the purpose of detecting any such motive, which, if detected, will certainly vitiate the action of the board at the election of the company.

§ 1604. **Whether Contract between Corporation and Directors is prima facie voidable** — *Rights of Endorsee of Note executed on behalf of Corporation by Officers named as Payees.* — Although, as we have seen, under many circumstances a contract between a director and his company may be valid, yet any such contract may fairly be regarded as *prima facie* voidable,² being unimpeachable only when approval by the shareholders, or some other circumstance sufficient to support it, is affirmatively proved. Accordingly, the fact that a promissory note shows on its face that it was executed on behalf of the company by the very officers who are also payees is a cause for suspicion, so that, according to many authorities, every endorsee is charged with

¹ *Bennett's Case*, 5 De G. M. & Supp. 155 (in action of contract against a corporation, plea "that

Cf. *Eyre's Case*, 31 Beav. 177. at the time of the making of the

² But see *Beach v. McKinnon*, alleged contract . . . the plaintiff was a director of the defendant company" held bad).

notice of an infirmity and therefore takes subject to the company's right of rescission;¹ but the contrary has been held by some courts.²

§ 1605-§ 1606. *Right of Company to enforce Contract or other Transaction with Directors.*

§ 1605. **In general.** — Of course, as the equitable doctrine in regard to contracts between directors and their company is designed for the protection of the company, contracts with directors not being void but merely voidable at the option of the corporation, they may be enforced by the company against the directors.³ It follows that the company may always recover

¹ *Smith v. Los Angeles Immigration, etc. Ass'n*, 78 Cal. 289; 20 Pac. 677; *Saylor v. Commonwealth Investment, etc. Co.*, 62 Pac. 652; 38 Oreg. 204; *Chemical Nat. Bank v. Wagner*, 93 Ky. 525; 20 S. W. 535; 40 Am. St. Rep. 206; *Third Nat. Bank v. Marine Lumber Co.*, 44 Minn. 65; 46 N. W. 145; *Capital City Brick Co. v. Jackson* (Ga.), 59 S. E. 92; *Park Hotel Co. v. Fourth Nat. Bank*, 86 Fed. 742; 30 C. C. A. 409.

Cf. *Cole v. Millerton Iron Co.*, 59 Hun (N. Y.) 217; 13 N. Y. Supp. 851; *Kitchens v. J. H. Teasdale Commission Co.*, 79 S. W. 1177; 105 Mo. App. 463; *German Savings Bank v. Des Moines Nat. Bank* (Iowa), 98 N. W. 606; 122 Iowa 737; *Manhattan Web Co. v. Aquidneck Nat. Bank*, 133 Fed. 76; *Mendel v. Boyd*, 91 N. W. 860; 3 Nebr. (Unofficial Rep.) 473; *Africa v. Duluth News-Tribune Co.* (Minn.), 84 N. W. 1019; 82 Minn. 283; 83 Am. St. Rep. 424; *Orr v. South Amboy Terra Cotta Co.*, 113 N. Y. App. Div. 103 (holding that the fact of a director being payee of a note executed on behalf of the company does not charge an endorser with notice, although the rule would have been different if the officer by whom the note was signed had

been the payee); *Wheeling Ice, etc. Co. v. Connor* (W. Va.), 55 S. E. 982.

As to share-certificates issued by officers of a corporation to themselves, see § 919.

² *Doe v. Northwestern, etc. Co.*, 78 Fed. 62, 68-69 (headnote inadequate).

Cf. *St. Joe, etc. Mining Co. v. First Nat. Bank*, 10 Colo. App. 339, 347-349 (headnote inadequate); 50 Pac. 1055; *Campbell v. Upton*, 66 N. Y. App. Div. 434; 73 N. Y. Supp. 1084; *Bank of New South Wales v. Goulburn Valley Butter Co.* (1902), A. C. 543; *Jones v. Hanna*, 60 S. W. 279; 24 Tex. Civ. App. 550 (deed to president of corporation executed by himself on behalf of company); *State ex rel. Grimm v. Manhattan Rubber Mfg. Co.*, 149 Mo. 181; 50 S. W. 321 (note executed by president in favor of a director not *prima facie* invalid); *Fillebrown v. Hayward*, 190 Mass. 472; 77 N. E. 45 (applying the Negotiable Instruments Law).

That a director's possession of bearer bonds issued by the corporation is not a suspicious circumstance sufficient to charge a purchaser with notice of infirmities in his title, see *infra*, § 1623.

³ *Veeder v. Horstmann*, 85 N. Y. App. Div. 154; 83 N. Y. Supp. 99;

from a director money that it may have lent to him, and is entitled to the benefit of any security given therefor.¹ Not only so, but statutes expressly prohibiting loans to a director are deemed to be intended solely for the company's benefit, and therefore do not prevent the corporation from enforcing a loan made in violation of the statute and from realizing on any collateral security given by the director.² So, too, a statute declaring that bonds issued to a director shall be void has been construed to mean voidable at the option of the company, and not to make such bonds void as regards other creditors.³ A director who borrows money from the company and promises to pay usurious interest will not be allowed to avail of the usury laws so as to evade the payment of the principal debt and legal interest.⁴

§ 1606. **Action as Director as Waiver of Director's individual Rights.** — Inasmuch as the corporation may always elect to affirm a transaction by directors with themselves, it would seem that a director who votes upon a matter in which he has an individual interest may be deemed by the corporation to waive any objection to action taken in accordance with his vote, on the ground that it interferes with his individual rights. However, in a recent Australian case, where a director had concurred in action on the part of the company which amounted to a breach of a valid

Consolidated Fruit Jar Co. v. Wisner, 103 N. Y. App. Div. 453; 93 N. Y. Supp. 128 (holding that price fixed for goods sold to director is binding on him but not on the company).

Cf. *Holm v. Atlas Nat. Bank*, 84 Fed. 119; 28 C. C. A. 297 (as to company's rights as bona fide purchaser of property bought from a director); *Whittle v. Vanderbilt Mining, etc. Co.*, 83 Fed. 48 (same point).

¹ Cf. *Conyngham's Appeal*, 57 Pa. St. 474 (holding that the borrowing director may recover for an unauthorized sale of the collateral just as if he had been an outsider); *Garrison Canning Co. v. Stanley* (Iowa), 110 N. W. 171 (where the company claimed, unsuccessfully, to set aside the express contract and recover the

money lent as a preferred claim against the borrowing director's estate).

² *Bowditch v. New England Life Ins. Co.*, 141 Mass. 292; 4 N. E. 798; 55 Am. Rep. 474; *Savings Bank v. Burns*, 104 Cal. 473; 38 Pac. 102; *Brittan v. Oakland Bank*, 124 Cal. 282; 57 Pac. 84; 71 Am. St. Rep. 58; *Lester v. Howard Bank* 33 Md. 558; 3 Am. Rep. 311 (distinguishing *Albert v. Savings Bank*, 2 Md. 159); *People's Trust Co. v. Papst*, 113 N. Y. App. Div. 375; 98 N. Y. Supp. 1045.

³ *Toledo, etc. R. R. Co. v. Continental Trust Co.*, 95 Fed. 497, 525-529; 36 C. C. A. 155.

⁴ *Gund v. Ballard* (Nebr.), 103 N. W. 309.

contract between himself and the corporation, the court held that his conduct did not amount to a waiver of his rights under the contract.¹ The reasoning was that it might be the director's duty as director to break the contract. It is submitted, however, that the director's proper course was to refrain from acting on behalf of the company in the matter, and that having acted he should have been taken to waive his individual rights.² The corporation should have the option of repudiating the transaction on the ground that the director who was adversely interested participated therein, but if the company elects to stand by the action, the director should not be allowed to complain of it as breach of his individual rights.

§ 1607-§ 1631. ACCOUNTABILITY OF DIRECTORS TO THE COMPANY FOR PROFITS MADE FROM THE OFFICE.

§ 1607. *In general.* — Directors being fiduciaries, the general rule of equity is applicable that all profits made by virtue of their office belong to the company, except such as the regulations of the corporation or the resolutions of its shareholders permit them to retain. This rule is sometimes expressed by saying that directors are liable for all *secret* profits made by their position;³ but in reality that statement is too narrow. For directors must account for all profits of their office, secret or not, which they have not been allowed to retain by the company.⁴ Of course, if the fact that the directors are making or about to make such profits is disclosed to a shareholders' meeting, the latter must claim them promptly, or will be held to have waived all rights thereto. But mere disclosure of the profits will not protect the directors: there must be some active or passive sanction by a shareholders' meeting. Disclosure is material only because shareholders cannot in general sanction the retention of profits of the very existence of which they have not been informed.

¹ *Glass v. Pioneer Rubber Works*,
31 Vict. L. R. 754, 773.

² Compare *supra*, § 1242.

³ Cf. *Goldshear v. Barron*, 42 N. Y. Misc. 198; 85 N. Y. Supp. 395.

⁴ Cf. *Goodell v. Verdugo Cañon Water Co.*, 138 Cal. 308, 314; 71 Pac. 354.

§ 1608-§ 1610. *Profits made on Contracts or other Dealings between Directors and the Company.*

§ 1608. **In general.**—The profits of directors often arise from dealings between them and the company. How far such dealings are binding has been considered above; and if the contract or other dealing is binding, the director is entitled to his profits.¹ But wherever a contract or dealing between directors and their company is made in disregard of the principles of law considered above—a contract or dealing which therefore the company might avoid—the company may, as a substitute for the remedy of rescission, where rescission is impossible or undesirable, require the interested directors to account for their profits on the transaction.² This is sometimes expressed by saying that the corporation has an election either to rescind the transaction or to affirm it and compel the misconducting director to account for his profits.³

This statement is quite accurate if applied to cases where the contract in question has been executed before the question of rescission *vel non* comes before the corporation—that is, the shareholders, or a disinterested board of directors. But if the shareholders, while the contract is still executory, with full knowledge of the matter, elect to confirm, then the contract becomes, on the principles considered above, altogether unimpeachable, and the interested director cannot be required to

¹ *Tenison v. Patton*, 67 S. W. 92; *Co. v. Ball*, 104 N. Y. Supp. 771; 53 95 Tex. 284. The proposition stated in the text is tacitly accepted in all the cases which hold that, in certain

circumstances more particularly set out above, a director is entitled to enforce contracts between himself and the company.

² *Imperial Mercantile Ass'n v. Coleman*, L. R. 6 H. L. 189; *Benson v. Heathorn*, 1 Y. & C. Ch. 326; *Parker v. Nickerson*, 112 Mass. 195; *Perry v. Tuskalooza, etc. Co.*, 93 Ala. 364; 9 So. 217; *Spaulding v. North Milwaukee Town Site Co.*, 106 Wisc. 481; 81 N. W. 1064; *Lozier Motor*

Cf. First Nat. Bank v. Drake, 29

Kans. 311; 44 Am. Rep. 646; *Reynolds v. Bank of Mt. Vernon*, 6 N. Y. App. Div. 62; 39 N. Y. Supp. 623, affirmed short in 158 N. Y. 740; 53

N. E. 1131 (director not liable to account for profits made with money lent him by the company in violation of a somewhat ambiguous legal prohibition).

³ *Gilman, etc. R. R. Co. v. Kelly*, 77 Ill. 426.

account for his profits.¹ The question as to the company's right to profits made by a director on dealings with it generally arises in respect to sales, etc., which are wholly executed before any question of confirmation or rescission can come before the shareholders. And in respect to such executed contracts, the company has an election either to rescind, if rescission (including a restoration of both parties to substantially the *status in quo*) is feasible, or to affirm and demand an account of the director's profits.² The company must take either one course or the other; they cannot rescind the transaction in part and affirm it in part.³ The rights of the company in these respects are the same as in the case of contracts between a corporation and its promoters.⁴

§ 1609. **Arbitrary Exception in England.** — In England, it seems that this right of the company to profits made by its directors is subject to the same arbitrary exception as in the case of promoters.⁵ That is to say, where property in which a director has an interest is sold to the corporation as the property of strangers, but with full disclosure of all the material circumstances with the exception of the director's interest, the only remedy of the corporation is rescission. If rescission is not desired or is impracticable, the company is remediless and cannot recover the director's profit.⁶ This doctrine is open to the same objections as in the case of promoters, and will not, it is hoped, be adopted in the United States.⁷

§ 1610. **Profits made by Firm or Corporation of which Director is a Member upon Dealings with the Company.** — Where the profits are made on dealings with the company by a firm of which a director is a member, both he and the other partners have been held jointly and severally liable to the company for the full amount of the profits made by the firm, and not each

¹ *Grant v. United Kingdom Switch-back, etc. Co.*, 40 Ch. D. 135.

² As to what are proper allowances to a director in such an accounting, see *Parker v. Nickerson*, 112 Mass. 195, 199.

³ *Great Luxembourg Ry. Co. v. Magnay*, 25 Beav. 586.

⁴ As to which see *supra*, § 383-§ 390.

⁵ As to which see *supra*, § 385.

⁶ *Burland v. Earle* (1902), A. C. 83, 98-99.

⁷ Cf. *Benson v. Heathorn*, 1 Y. & C. Ch. 326; *Cushing Sulphite Fibre Co. v. Cushing*, 2 New Brunsw. Eq. 539, 541 (headnote inadequate).

⁸ Cf. *Parker v. Nickerson*, 112 Mass. 195, 197; *Goodin v. Cincinnati, etc. Canal Co.*, 18 Oh. St. 169; *Brooklyn, etc. R. R. Co. v. Strong*, 75 N. Y. 591; *Voorhees v. Nixon* (N. J.), 66 Atl. 192.

only for his own individual profit.¹ This is clearly correct in any case where the partner who is not a director is aware of, and therefore party to, his associates' fiduciary position and consequent breach of trust.² But if a profit were made by a director as a shareholder in another corporation, surely the other members of that corporation would not be liable to account to the former corporation for their profits on the transaction, — not even in those jurisdictions in which dealings between two corporations a director of one of which is a shareholder in the other are held to be irregular.³

§ 1611. **Bribes or Presents from a Person having Dealings with the Company.** — With the possible exception of profits made upon contracts or other dealings between directors and the company, the most common kind of unlawful profits of directors consists in bribes or presents from persons dealing with the company. Sometimes such presents can be proved to have been corruptly given for the purpose of influencing the director's actions against his conscience; but more often the fraudulent purpose is so carefully disguised as to be impossible of proof. The law, however, jealous of all appearance of evil, wisely makes no distinction between the cases; even where all is done in the best of faith, the directors must account to the company for all presents or commissions given or paid to them by any person who has or contemplates having any contract or dealing with the corporation.⁴ Most of the decisions on this subject

¹ *Imperial Mercantile Ass'n v. Coleman*, L. R. 6 H. L. 189. *Kans.* 365, 399; *Wade v. Kendrick*, 37 Can. Sup. Ct. 32.

Cf. *Rickert v. White*, 105 N. Y. Supp. 653 (decree for accounting against director partner without stating whether he should be liable for the entire profit realized by the firm).

Cf. also *supra*, § 1580.

² *Fountain Spring Park Co. v. Roberts*, 92 Wisc. 345; 66 N. W. 399; 53 Am. St. Rep. 917; *Hoffman, etc. Coal Co. v. Cumberland, etc. Co.*, 16 Md. 456, 509; 77 Am. Dec. 311; *Ryan v. Leavenworth, etc. Ry. Co.*, 21

Cf. Boston Deep Sea, etc. Co. v. Ansell, 39 Ch. D. 339; *Costa Rica Ry. Co. v. Forwood* (1901), 1 Ch. 746, 758.

But see *Goodin v. Cincinnati, etc. Co.*, 18 Oh. St. 169.

⁴ *General Exchange Bank v. Horner*, 9 Eq. 480; *Eden v. Ridsdale, etc. Co.*, 23 Q. B. D. 368; *Hay's Case*, 10 Ch. 593; *Oxford Bldg. Soc.*, 35 Ch. D. 502, 518; *Bent v. Priest*, 86

have been cases where the present was made by a person selling property to the corporation, but of course the principle would be applicable to any other contract or dealing. If the acceptance of such a present were sanctioned by the constitution of the company, the director would probably incur no liability in the absence of actual fraud.¹ The principle under consideration does not prevent a director from accepting gifts clearly prompted by some other motive than his connection with the company: for instance, a father might make his son a Christmas gift although the latter be director of a company with which the former had dealings. The prohibition of presents to a director from a person having business with the corporation continues until the contract or other dealing is completely executed,² and the burden of proving that the gift was made after the entire execution of the contract rests upon the director.³ Indeed, the gift is equally unlawful if made immediately after the completion of the transaction between the donor and the company, and that too whether or not in pursuance of a previous understanding.⁴

§ 1612. **Profits made on Bargains or Contracts with any Person having unexecuted Dealings with the Company.**—The same principle of law which forbids directors to receive outright presents from any one dealing with the corporation also prohibits them—though the danger of corruption is less patent—for bargaining with him for any advantage to themselves.⁵ For instance, while a director is at perfect liberty to purchase the company's shares in the open market, he may not buy from one who

Mo. 475; *Farmers', etc. Bank v. Downey*, 53 Cal. 466; 31 Am. Rep. 62; *Paducah Land, etc. Co. v. Hayes*, 15 Ky. Law Rep. 517; 24 S. W. 237; *The Telegraph v. Loetscher*, 101 N. W. 773; 127 Iowa 383; *Scott v. Farmers', etc. Nat. Bank*, 75 S. W. 7; 97 Tex. 31.

¹ In *Clark & Helden's Case*, 37 L. T. 222, a provision in the articles of association authorizing the directors to receive presents from persons selling property to the company was held to be fraudulent and void.

² *Eden v. Ridsdale, etc. Co.*, 23 Q. B. D. 368.

Cf. *European, etc. Ry. Co. v. Poor*, 59 Me. 277.

³ *Weston's Case*, 10 Ch. D. 579.

⁴ *Madrid Bank v. Pelly*, 7 Eq. 442, 447.

⁵ See *Kelsey v. New England Street Ry. Co.*, 48 Atl. 1001; 62 N. J. Eq. 742. As to whether a director made upon dealings between himself and a corporation having unexecuted contracts with his own company, compare *Costa Rica Ry. Co. v. Forwood* (1901), 1 Ch. 746, 758-759, 765, 767-768.

is under a special contract to take shares from the corporation, until that contract is quite executed.¹ In the same way, a railway director has been declared to be liable to account for all profits which he makes by investing in shares in a corporation with which the railway has just concluded an important contract — still unexecuted — for the construction of its railroad.² On the other hand, it has been held that a director may accept from one of the company's debtors payment or satisfaction of a claim owing to the director individually, and that, too, where the transaction amounts to a preference of the director's claim over that of the company.³ In the same case, it was held that the director incurs no liability because shares in the company itself were used by the debtor to satisfy the director's claim.⁴ This latter conclusion is doubtless logical enough, but the former certainly goes to the verge of the law.

§ 1613. *Bird Coal and Iron Co. v. Humes*, 157 Pa. St. 278. — An interesting and unique case is *Bird Coal & Iron Co. v. Humes*.⁵ There, a shareholder in a mining company, having filed a bill to set aside a lease of certain coal lands which had been made by the corporation and by which lease a royalty or rent of fifteen cents on every ton of coal mined was reserved to the company, an arrangement or compromise was made between the complaining shareholder and the lessee whereby the bill was dismissed on the latter's agreeing to pay to that shareholder individually an additional royalty of three cents a ton. Although this contract was not disclosed to the company, yet in its inception it was held to have been valid; for the shareholder stood in no fiduciary relation to the company. But subsequently, the

¹ *Parker v. McKenna*, 10 Ch. 96. of equity to interpose an objection
Cf. *Cook v. Berlin Woolen Mill Co.*, to the consummation of a compro-
43 Wisc. 433; *Wing v. Charleroi* mise between the railroad company
Plate Glass Co., 112 Fed. 817. and the contractor." See also *Euro-*

But see *Van Cott v. Van Brunt*, 82 *pean, etc. Ry. Co. v. Poor*, 59 Me. 277.
N. Y. 535. ³ *Farmers', etc. Bank v. Wasson*,

² *Gilman, etc. R. R. Co. v. Kelly*, 48 Iowa 336, 341-342; 30 Am. Rep.
77 Ill. 426 (semble). 398.

Cf. *Paine v. Lake Erie, etc. R. R.* ⁴ *Farmers', etc. Bank v. Wasson*,
Co., 31 Ind. 283, 353, where the 48 Iowa 336, 341-342; 30 Am. Rep.
court said that directors of a railway 398.

company "could not acquire such an ⁵ *Bird Coal & Iron Co. v. Humes*,
interest in the profits of a contract 157 Pa. St. 278; 27 Atl. 750; 37
for the construction of the road as Am. St. Rep. 727.

would give them standing in a court

same shareholder having been in the meanwhile elected a director, the lessee alleged that by reason of increased competition he would be unable to continue business without a reduction in the royalty. Accordingly, the board of directors, acting upon the advice of the interested director, who did not disclose his individual contract above mentioned, consented to a reduction of three cents a ton on the company's royalty. The court held that, in failing to make disclosure, the director in question had violated his duty, and rendered himself liable to account for his secret profit on the transaction; but, as his original contract for a personal royalty was not unlawful, the measure of his profit was not the full three cents a ton, and therefore he should be required to bear merely his proportionate part of the reduction of the rental or royalty. Therefore, he was liable to the company for one sixth of three cents for every ton mined after the reduction took effect.

§ 1614-§ 1616. *Presents made to Directors to induce them to accept or resign the Office.*

§ 1614. **In general.** — Another application of the principle that directors must account to the company for all profits made by virtue of their office is found in those cases where some gift or present has been made to them in order to induce them to accept office. All such gifts belong in equity to the company.¹ In most of the cases, the gift was made by some one who had or was expecting to have some dealings with the corporation, so that it would fall within the rule stated in the preceding paragraph; but it is conceived that, by whomsoever made, such a present is a profit secured to the director by his office, and therefore belongs in equity to the company. The acceptance of such a present, while it makes the recipient the paid tool of the giver and should subject his actions to a rigid scrutiny, does not make him liable for all the wrongs to the company which the donor may commit.²

Upon the same principle, a gift to a director to induce him to resign, so that the donor or his friends may be chosen to fill the

¹ *Brighton Brewery Co.*, 37 L. J. Case, 5 Ch. D. 306; *McLean's Case*, Ch. 278; *Postage Stamp, etc. Co.* 55 L. J. Ch. 36.
(1892), 3 Ch. 566; *De Ruvigne's* ² *Perry's Case*, 34 L. T. 716, 717.

vacancy and thus acquire control of the corporation, may be recovered by the company.¹

§ 1615. **Gifts of Qualification Shares.** — Gifts made for the purpose of inducing a person to accept office as director most frequently take the form of a presentation of his qualification shares. Upon the principles stated above, the director must of course account to the company for such a present.² Generally the gift of the qualification shares is unconditional; the transaction is even more objectionable where a promoter agrees with a director to purchase the latter's qualification shares at the expiration of his period of office at the price he may have paid for the same, and accordingly the director must pay to the company any sums received by him under such a contract.³

§ 1616. **Gifts made before Donee becomes a Director.** — In order that a gift or present should be illegal for the reasons set out in the foregoing paragraphs, it is not necessary that it take place after the recipient has actually become an incumbent of the office of director. Indeed, gifts of a director's qualification shares, which constitute, as stated above, one of the most common classes of such illegal presents, must in most cases necessarily be made before the donee has entered upon his office. The recipient is accountable for the gift if made while he is contemplating acceptance of the office.⁴

¹ *McClure v. Law*, 161 N. Y. 78; 55 N. E. 388; 76 Am. St. Rep. 262; *Bosworth v. Allen*, 168 N. Y. 157; 61 N. E. 163; 85 Am. St. Rep. 667; 55 L. R. A. 751.

In *Heineman v. Marshall*, 117 Mo. App. 546; 92 S. W. 1131, the principle stated in the text was recognized; but the court, notwithstanding an energetic dissenting opinion, held that the claim of the corporation could not be reached by a subsequent judgment creditor of the company on a bill for equitable execution. But it is submitted that the majority of the court confused the right of the corporation to avoid a fraudulent transaction, or transaction in which the directors are interested adversely to the company

— a right which as stated above can be exercised only by the corporation and not by individual creditors — with the right of the company to hold the director to account for unlawful profits — a right which constitutes an asset of the corporation, and like any other chose in action may be reached by garnishment proceedings or by a bill for equitable execution.

As to contracts to resign, see also *supra*, § 1431.

² *Pearson's Case*, 5 Ch. D. 336; *Carriage Co-operative Supply Co.*, 27 Ch. D. 322.

³ *Archer's Case* (1892), 1 Ch. 322.

⁴ *Hay's Case*, 10 Ch. 593; *Ormerod's Case*, 25 W. R. 765.

§ 1617-§ 1619. *Whether the Company may recover a Bribe or illegal Gift in specie, follow it into an Investment, etc.*

§ 1617. **In general.** — In many cases the illegal bribe or gift consists in money, and the company can in such cases clearly recover the money with interest. The opinion has been, however, judicially expressed that while such money is regarded in equity as belonging to the company, yet it is not so far a trust fund as to enable the corporation to follow it into an investment.¹ In other cases, the gift consists in property — most often in shares in the corporation; and in such cases, it seems clear on principle that the company may elect to take either the property itself, if it still remains in the director's possession, or its value. To this effect is a line of recent English dicta,² and some American cases;³ but an early decision of the House of Lords seems to deny the company's right to claim the gift or bribe *in specie*.⁴ At all events, the director cannot escape liability for the value of the gift by offering to surrender to the company the property or shares of which the gift consisted.⁵ The opinion has been expressed that where the property given has been sold by the director, the company may recover from him the price received;⁶ and, while this seems correct on principle, it is difficult to distinguish from following a money gift into an investment. If the property which a director acquires by abuse of his office be claimed by the company *in specie*, as we have seen above that the best authorities permit to be done, the director must account for the fair value of the use of the property while it was in his

¹ *Archer's Case* (1892), 1 Ch. 322, 338.

But see *Carling's Case*, 1 Ch. D. 115; per Mellish, L. J. Cf. *McClure v. Trask*, 161 N. Y. 82; 55 N. E. 407.

² *Carling's Case*, 1 Ch. D. 115, 126; *Pearson's Case*, 5 Ch. D. 336; *Nant-y-Glo, etc. Ironworks Co. v. Grave*, 12 Ch. D. 738; *Eden v. Ridsdale, etc. Co.*, 23 Q. B. D. 368.

³ *Chandler v. Bacon*, 30 Fed. 538; *Hayward v. Leeson*, 176 Mass. 310, 323; 57 N. E. 656; 49 L. R. A. 725; *Paducah Land, etc. Co. v. Hayes*, 15 Ky. L. Rep. 517; 24 S. W. 237.

⁴ *Tyrrell v. Bank of London*, 10 H. L. Cas. 26, 59 (criticised *supra*, § 377).

⁵ *Nant-y-Glo, etc. Ironworks Co. v. Grave*, 12 Ch. D. 738; *McLean's Case*, 55 L. J. Ch. 36.

Cf. *Grand Rapids, etc. Co. v. Cincinnati, etc. Co.*, 45 Fed. 671.

⁶ *Carling's Case*, 1 Ch. D. 115, 126 (per Mellish, L. J.); *Chandler v. Bacon*, 30 Fed. 538, 540; *Hayward v. Leeson*, 176 Mass. 310, 323; 57 N. E. 656; 49 L. R. A. 725.

possession, even though he did not in fact realize so large an amount.¹

§ 1618. **Amount of Recovery where Company elects to claim the Value of the Gift.** — Where the corporation elects to take the value of the illegal gift or profit, it would seem that the value ought to be estimated as of the date of its acceptance by the director. Where the gift consists in shares of stock, and where about the time of the gift other shares have been taken at par by the directors themselves,² or by the public at large,³ the shares will be taken as against the misconducting director to have been worth par. That is their *prima facie* value, and the burden of showing a less value rests on the wrongdoer;⁴ and some judges have gone so far as to hold that the fiduciary is never liable for less than the par value of the shares.⁵ In some cases, the directors have been pronounced liable for the highest value of the shares while held by them; but no satisfactory reason has been given for this severe rule of damages,⁶ although it must be remembered that in some jurisdictions a similar rule is enforced in ordinary actions for conversion. At all events, where the directors held a large number of shares which they could not have offered for sale without depressing the market, they will not be liable for the very highest price at which single shares may have sold.⁷ Where the shares have passed into the hands of a voluntary but *bona fide* holder, he is liable to the company for their value at the date of his refusal to surrender them on the corporation's demand.⁸

In one case, the court refused to allow interest on the value of the shares where no dividends had been paid, so that the company had lost no interest.⁹

¹ *Fricker v. Americus Mfg., etc. Co.*, 52 S. E. 65; 124 Ga. 165. *v. Grave*, 12 Ch. D. 738; *Eden v. Ridsdale, etc. Co.*, 23 Q. B. D. 368.

² *Postage Stamp, etc. Co.* (1892), 3 Ch. 566; *Weston's Case*, 10 Ch. D. 579. Cf. *Hirsche v. Sims* (1894), A. C. 654; *Hayward v. Leeson*, 176 Mass. 310, 322-323; 57 N. E. 656; 49 L. R. A. 725.

³ *De Ruvigne's Case*, 5 Ch. D. 306; *Pearson's Case*, 5 Ch. D. 336; *Mitcalfe's Case*, 13 Ch. D. 169. ⁷ *Shaw v. Holland* (1900), 2 Ch. 305.

⁴ *Mitcalfe's Case*, 13 Ch. D. 169, 173. ⁸ *Paducah Land, etc. Co. v. Hayes*, 24 S. W. 237; 15 Ky. Law Rep. 517.

⁵ *Grand Rapids, etc. Co. v. Cincinnati, etc. Co.*, 45 Fed. 671. ⁹ *Fitzroy Bessemer Steel Co.*, 50

⁶ *Nant-y-Glo, etc. Ironworks Co.* L. T. 144, 147.

§ 1619. **Whether Director to whom Gift of nominally paid-up Shares is made is liable as Holder of unpaid Shares.** — Where a director is presented with shares issued by the company as paid-up, whilst he may be required to account to the company for the shares or their value, yet he cannot be held as the holder of unpaid shares.¹ This proposition, which is supported by the weight of authority, seems to have been disregarded in at least one case.² As the shares purport to be paid-up, the company is estopped from holding the director as transferee of unpaid shares;³ and the measure of the director's profit is not the par value of the shares, but their actual value if treated as paid-up shares. But where the director subscribes for shares and pays for them with money given to him by a promoter, he is in reality merely paying the company its own money, and therefore the shares remain unpaid for, and he may be held as owner of unpaid shares.⁴

§ 1620–§ 1626. *Profits made by acting in a Manner likely to interfere with Performance of Duty to the Company.*

§ 1620. **Purchase by Director of Property needed by the Company.** — Wherever a director for his own private ends takes any action that interferes or tends to interfere with the performance of his duty to the company, he must account for his profits on the transaction. A director will be held in equity as trustee of property which he has been ordered by the company to purchase for it, or which he knows by virtue of facts learned in his official position that the company will need, and which he attempts to buy for himself;⁵ but if the corporation expressly

¹ *De Ruigne's Case*, 5 Ch. D. 306; 6 N. Y. Supp. 255 (headnote inadequate). *Carling's Case*, 1 Ch. D. 115; *Currie's Case*, 11 W. R. 46; *Innes & Co.* (1903), 2 Ch. 254.

² *Carriage Co-operative Supply Co.*, 27 Ch. D. 322. The decision seems to rest on a misconception of *Hay's Case*, 10 Ch. 593, stated *infra*.

³ *Supra*, § 800.

⁴ *Hay's Case*, 10 Ch. 593.

⁵ *Cf. Eastwick's Case*, 34 L. T. 84.

⁵ *Blake v. Buffalo Creek R. R.* Cf. *Barr v. Pittsburgh Plate Glass Co.*, 56 N. Y. 485; *Averill v. Barber, Co.*, 57 Fed. 86; 6 C. C. A. 260

But see *Lagarde v. Anniston Lime, etc. Co.*, 126 Ala. 496 (headnote misleading); 28 So. 199; *Mackey v. Burns*, 64 Pac. 485; 16 Colo. App. 6; *De Bardeleben v. Bessemer Land, etc. Co.*, 140 Ala. 621; 37 So. 511; *Kroegher v. Calivado Colonization Co.*, 119 Fed. 641; 56 C. C. A. 257; *Camden Land Co. v. Lewis*, 101 Me. 78; 63 Atl. 523.

repudiates the purchase as made for its benefit, and declares that the director acted only on his own behalf, it cannot, long afterwards, change front, and lay claim to the property.¹ So, if a director renews in his own name a lease held by the company, he takes the lease as trustee for the company;² but, on the other hand, if the landlord has refused to renew the lease to the company, a director may, it seems, take a new lease for his own benefit.³

Where a director purchases with his own money mortgages on the company's property which he was deputed to buy on its behalf, he is entitled to interest on the amount expended by him.⁴

§ 1621. **Engaging in a competing Business.** — It has been held, that a director may engage on his own account in a competing business, and incurs no accountability to his company for so doing;⁵ but it would certainly seem that such conduct is inconsistent with that singleness of purpose which every director owes to his corporation.

§ 1622. **Invention of Director for facilitating the Company's Work.** — A corporation has no right to the use of an invention made and patented by one of its directors even where the patent covers a device for facilitating the work carried on by the company.⁶ The director is entitled to claim the invention as his

(where a director built up a rival business which was afterwards sold to the company with the approval of the shareholders); *McDermott Mining Co. v. McDermott*, 69 Pac. 715; 27 Mont. 143 (where a director purchased a mining claim which had been forfeited by the company).

¹ *Sandy River R. R. Co. v. Stubbs*, 77 Me. 594; 2 Atl. 9.

Cf. *Seymour v. Spring Forest, etc. Ass'n*, 144 N. Y. 333, 343; 39 N. E. 365; 26 L. R. A. 859; *American Circular Loom Co. v. Wilson* (Mass.), 84 N. E. 133.

² *McCourt v. Singers-Bigger*, 145 Fed. 103; 76 C. C. A. 73 (containing a valuable discussion as to what credits should be allowed the director in accounting for profits made by him out of the renewed lease). Cf. *Acker, Merrall & Condit*

Co. v. McGaw (Md.), 68 Atl. 17 (stated supra, § 1529).

But see *Jacksonville Cigar Co. v. Dozier* (Fla.), 43 So. 523.

³ Cf. *Crittenden, etc. Co. v. Cowles*, 66 N. Y. App. Div. 95; 72 N. Y. Supp. 701.

⁴ *Kroegher v. Calivada Colonization Co.*, 119 Fed. 641, 651; 56 C. C. A. 257.

⁵ *New York Automobile Co. v. Franklin*, 49 N. Y. Misc. 8; 97 N. Y. Supp. 781 (note that the decision would be clearly sound if it be a fact, as stated in the headnote in the report last cited, that the director did not engage in the competing business until after he had retired from office).

⁶ *Burden v. Burden Iron Co.*, 39 N. Y. Misc. 559; 80 N. Y. Supp. 390; *American Circular Loom Co. v. Wilson* (Mass.), 84 N. E. 133.

own and to collect a reasonable royalty from the company for its use.

§ 1623. **Purchase by Director of the Company's Bonds or other Obligations.**—Directors being under no duty to pay off the company's bonds or other obligations before maturity, may according to the weight of authority purchase them from their holders at less than par, and enforce them against the company for their face value.¹ And, although this may on principle be open to doubt,² yet clearly if the company desires to claim the benefit of the contract it must so elect with reasonable promptitude, or it will be held to have waived its rights.³ The court will not presume that a purchase of the company's bonds by a director was made with the company's funds.⁴ Very clearly, the possession of bonds by a director, or his offering of them for sale for his private purposes, is not a suspicious circumstance, nor sufficient to cast upon a purchaser the onus of inquiring whether he acquired them by breach of duty.⁵ If debentures are issued by

¹ *Seymour v. Spring Forest, etc. Ass'n*, 144 N. Y. 333, 342-345; 39 N. E. 365; 26 L. R. A. 859; *St. Louis, etc. R. R. Co. v. Chenault*, 36 Kans. 51; 12 Pac. 303; *Glenwood Mfg. Co. v. Syme*, 109 Wisc. 355; 85 N. W. 432; *Camden Safe Deposit, etc. Co. v. Citizens' Ice, etc. Co.* (N. J.), 61 Atl. 529.

But see contra: *Moses v. Ocoee Bank*, 1 Lea (Tenn.) 398, 413.

Cf. *Higgins v. Lansingh*, 154 Ill. 301; 40 N. E. 362; *Covington, etc. R. R. Co. v. Bowler's Heirs*, 9 Bush (Ky.) 468; *Hill v. Frazier*, 22 Pa. St. 320; *Harris v. Union Pac. Ry. Co.*, 13 Fed. 522 (headnote inadequate); *McIntyre v. Ajax Mining Co.* (Utah), 77 Pac. 613; *Schraeder v. Heinzelman Bros.*, 51 Ill. App. 31; *McDonald v. Houghton*, 70 N. Car. 393 (holding that a director who has purchased a claim against his company at a discount, cannot compel the vendor, if he collects the full amount, to turn it over to him). In *Forest Glen Brick Co. v. Gade*, 155 Ill. App. 181, the court held that directors who buy up an outstand-

ing claim against the company are entitled to the benefit of any security given therefor.

Risley v. Indianapolis, etc. R. R. Co., 62 N. Y. 240, is a case with some unusual features where a contract for the construction of a railway was assigned to the company's president.

² Cf. *Bramblet v. Commonwealth Land, etc. Co.*, 83 S. W. 599; 26 Ky. Law Rep. 1176; 84 S. W. 545; 27 Ky. Law Rep. 156 (where a president of a company who bought in a judgment against it was not allowed to enforce the judgment for the full amount); *The Telegraph v. Lee*, 98 N. W. 364; 125 Iowa 17.

³ *Seymour v. Spring Forest, etc. Ass'n*, 144 N. Y. 333, 345; 39 N. E. 365; 26 L. R. A. 859; *Glenwood Mfg. Co. v. Syme*, 109 Wisc. 355; 85 N. W. 432.

⁴ *Seymour v. Spring Forest, etc. Ass'n*, 144 N. Y. 333, 345-346; 39 N. E. 365; 26 L. R. A. 859.

⁵ *Duncomb v. N. Y., etc. R. R. Co.*, 84 N. Y. 190, 203, 205; *Railway Co. v. Sprague*, 103 U. S. 756, 760

directors irregularly but in such a way as to be valid in the hands of a holder without notice of the irregularity, a director purchasing from a *bona fide* holder acquires all the latter's rights,¹ the courts refusing to apply the analogous doctrine by which a trustee who wrongfully parts with trust property and subsequently repurchases from a *bona fide* holder takes subject to the trust. Of course, a director who purchases at par maturing coupons of the company's bonds for the purpose of holding them and thus preventing a default and a possible receivership is guilty of no manner of wrong.²

If a director may purchase bonds of the company and enforce them against the corporation, he may presumably purchase from a contractor a supposedly valuable contract with the company. At all events, if he does so, his purchase does not render the contract wholly void: at most, the director becomes liable to account to the company for his profits on the contract. Consequently, a reassignment of the contract by the director to another person is certainly not illegal, and may constitute good consideration for an assumpsit.³

§ 1624. **Purchase of Company's Property at a Judicial Sale.** — Where a judgment or decree has been obtained against the company, and its property is selling on *feri facias*, or where any other judicial sale of the company's property is taking place, it seems on principle that the directors, whose duty is to protect the corporation, should not be allowed to purchase at the sale except for its benefit.⁴ But the contrary is held by many high

(headnote inadequate); *Ferris Irrigation District v. Thompson*, 116 Fed. 832; *Farmers' L. & T. Co. v. Madison Mfg. Co.*, 153 Fed. 310 (headnote inadequate).

Cf. *Union, etc. Trust Co. v. Southern Cal., etc. Co.*, 51 Fed. 840; *Wilson v. Metropolitan Elevated Ry. Co.*, 120 N. Y. 145; 24 N. E. 384; 17 Am. St. Rep. 625. See also *supra*, § 1004.

¹ *Owen & Ashworth's Claim* (1901), 1 Ch. 115, 121-122.

But see *Ex parte Larking*, 4 Ch. D. 566.

² *Ketchum v. Duncan*, 96 U. S. 659.

³ *Barnes v. Brown*, 80 N. Y. 527.

⁴ *Covington, etc. R. R. Co. v. Bowler's Heirs*, 9 Bush (Ky.) 468; *Rozecrans Gold Mining Co. v. Morey*, 111 Cal. 114; 43 Pac. 585; *Iron Clay Brick Mfg. Co.*, 19 Ont. 113; *McAllen v. Woodcock*, 60 Mo. 174; *Fricker v. Americus Mfg. Co.*, 52 S. E. 65; 124 Ga. 165.

Cf. *Hoyle v. Plattsburgh, etc. R. R. Co.*, 54 N. Y. 314; *Tobin Canning Co. v. Fraser*, 81 Tex. 407; 17 S. W. 25; *Raleigh v. Fitzpatrick*, 43 N. J. Eq. 501; 11 Atl. 1; *San Francisco Water Co. v. Pattee*, 86 Cal. 623; 25 Pac. 135; *Hoffman v. Reichert*, 147 Ill. 274; 35 N. E. 527; 37 Am. St. Rep. 219; *Fishel v. Goddard*, 69 Pac. 607; 30 Colo. 147.

authorities,¹ unless of course the purchase was tinged with actual fraud.² Some authorities go so far as to declare that a director may purchase for his own benefit at any public sale of the company's property if the transaction is proved to be *bona fide*;³ but this, of course, is contrary to the weight of authority.⁴ If the director holds a mortgage on property of the company as constructive trustee for the company, his rights are not increased by foreclosing the mortgage and buying in the property at a foreclosure sale.⁵ Where a director purchases property of the company at a sale under execution on a judgment held by him against the company, and the corporation succeeds in the contention that the purchase must be taken as made for its benefit, the director must be reimbursed for his expenditures, but cannot claim payment of his judgment as a condition to granting relief to the company.⁶

§ 1625. **Adverse Possession of Company's Property by Director.**—A director being charged with the duty of protecting the company's interests cannot acquire title to the corporate property by adversary possession.⁷

§ 1626. **Purchase at Execution Sale on Judgment in favor of the Company.**—Where a director purchases property of a judgment debtor of the company at the execution sale, the indi-

¹ *Twin-Lick Oil Co. v. Marbury*, Mass. 224, 230; 17 N. E. 316; *Cara-*
91 U. S. 587, 590-591; *Harts v. her v. Royal Ins. Co.*, 63 Hun (N. Y.)
Brown, 77 Ill. 226; *Preston v.* 82; 17 N. Y. Supp. 858.

Loughran, 58 Hun (N. Y.) 210; 12 ² *Jackson v. Ludeling*, 21 Wall.
N. Y. Supp. 313; *McMurtry v.* 616; *Hallam v. Indianola Hotel Co.*,
Montgomery Masonic Temple Co., 56 Iowa 178; 9 N. W. 111; *Coombs*
86 Ky. 206; 5 S. W. 570; *Rylander v. Barker*, 31 Mont. 526; 79 Pac. 1.

Sheffield, 108 Ga. 111; 34 S. E. ³ *Patterson v. Smelting Works*,
348; *Lucas v. Friant*, 111 Mich. 35 Oreg. 96; 56 Pac. 407.

426; 69 N. W. 735; *Horbach v.* ⁴ *Harts v. Brown*, 77 Ill. 226.

Marsh, 37 Nebr. 22; 55 N. W. 286; ⁵ *Kroegher v. Calivada Coloniza-*
Relender v. Riggs, 79 Pac. (Colo.) *tion Co.*, 119 Fed. 641; 56 C. C. A.
328; *New Memphis Gas Light Co.* 257.

Cases, 105 Tenn. 268; 60 S. W. ⁶ *San Francisco Water Co. v.*
206; 80 Am. St. Rep. 880; *Snediker Pattee*, 86 Cal. 623; 25 Pac. 135.

Ayres, 146 Cal. 407; 80 Pac. But see *Harpending v. Munson*,
511; *Marr v. Marr* (N. J.), 66 Atl. 91 N. Y. 650, 653-654.

182 (partly on the ground that the ⁷ *Center Creek Water, etc. Co. v.*
director was the execution creditor *Lindsay*, 21 Utah 192; 60 Pac. 559.

and purchased for his own pro- Cf. *Consolidated Plaster Co. v. Wild*
tection); *Law v. Fuller* (Pa.), 66 (Colo.), 94 Pac. 285.

Atl. 754.

Cf. *Saltmarsh v. Spaulding*, 147

vidual interest of the director is to get the property at the lowest possible price, while the interest of the company is to have the property bring as much as possible (until the amount of the judgment and costs have been realized), and consequently the company should have the right to treat the purchase as made for its benefit.¹

§ 1627. **Commissions as Receiver under Appointment made at the Company's instance.** — The fact that a director or officer of a company is appointed receiver by a court of equity in consequence of his official position, and at the instance of the company, does not enable the company to require him to account for his commissions as receiver, on the ground that they are profits made by virtue of his office.²

§ 1628. **Burden of Proof of Fact and Amount of Profit.** — Where a corporation seeks to recover from a director profits that he has made by virtue of his office, — as, for example, profits on contracts with the company in which his interest was not disclosed, — the company must prove that the director made a profit and also prove its amount.³ So, if the company is seeking to recover a bribe or unlawful gift given to a director, the fact of the unlawful present must be proved and must not rest on mere suspicion.⁴

But, sometimes, the effect of this rule can be avoided by a little ingenuity. Thus, where a contract was made with a corporation ostensibly by a third party but really for the benefit of one of the directors, by which a large sum of the company's money is paid out for services alleged to have been rendered, the corporation instead of suing to recover the amount of the director's profit, as to which evidence would be difficult to secure, may rescind the contract and call on the director to account for the money paid out, thus throwing upon him the burden of showing the true value of the services rendered, the difference between which and the sum paid would be recoverable by the company.⁵

¹ Cf. *Moses v. Ocoee Bank*, 1 Lea (Tenn.) 398, 411-412.

² *Citizens' Trust, etc. Co. v. Tompkins*, 97 Md. 182; 54 Atl. 617.

³ *Bentinck v. Fenn*, 12 A. C. 652. See supra, § 394.

⁴ *Mount Vernon Bank v. Porter*, 148 Mo. 176; 49 S. W. 982.

⁵ *Rutland Electric Light Co. v. Bates*, 68 Vt. 579; 35 Atl. 480; 54

Am. St. Rep. 904.

§ 1629. **Liability to account for Profits joint and several.** — As directors who have been guilty of mismanagement are liable jointly and severally,¹ so the liability of directors for unlawful presents, or other profits made by means of their office, has been held to be joint and several.² By this, it is not meant that where several directors independently receive separate bribes, each is to be liable as well for the gifts received by his fellows as for his own, but that where as part of one transaction two or more directors jointly receive some bribe or otherwise make an unlawful profit — that there, each is liable for the full amount of the collective profit.

§ 1630. **Limitations and Laches as Defence to Company's Claim for Director's Profits.** — In the case of bribes received by a director, or of other profits made by him out of his office, it has been held that the statute of limitations of 21 James I. c. 16, or any similar statute, begins to run from the time the facts are communicated to a properly constituted board of impartial directors.³ Moreover, laches may prevent the corporation from recovering the profits made by a director on an unlawful contract with the company.⁴

§ 1631. **Effect of Bankruptcy of Director.** — A company's claim against a director to recover a secret commission paid to him by a person who was selling property to the company, has been held to be a claim for a breach of trust so that a discharge in bankruptcy is no defence to the defendant director.⁵ Such claims are, however, deemed to arise "by reason of contract," and are therefore provable in bankruptcy against the estate of the director.⁶

¹ Supra, § 1548.

² *London & Provincial Starch Co.*, 20 L. T. 390; *Carriage Co-operative Supply Ass'n*, 27 Ch. D. 322.

Cf. *Emery v. Parrott*, 107 Mass. 95; *Rutland Electric Light Co. v. Bates*, 68 Vt. 579; 35 Atl. 480; 54 Am. St. Rep. 904; *Zinc Carbonate Co. v. First Nat. Bank*, 103 Wis. 125, 135; 79 N. W. 229; 74 Am. St. Rep. 845 (a case of promoters).

But see *Loudenslager v. Woodbury Heights Land Co.*, 58 N. J. Eq. 556; 43 Atl. 671 (also a case of promoters).

³ *Metropolitan Bank v. Heiron*, 5 Ch. D. 319. Cf. *Atl. Nat. Bank v. Harris*, 118 Mass. 147; *Ryan v. Leavenworth, etc. Ry. Co.*, 21 Kans. 365, 404-405; *Bent v. Priest*, 86 Mo. 475; *The Telegraph v. Loetscher*, 101 N. W. 773; 127 Iowa 383. ⁴ *Pneumatic Gas Co. v. Berry*, 113 U. S. 322, 327 (headnote inadequate); 5 Sup. Ct. 525.

⁵ *Emma Silver Mining Co. v. Grant*, 17 Ch. D. 122.

⁶ *Emma Silver Mining Co. v. Grant*, 17 Ch. D. 122.

§ 1632-§ 1634. *Contracts tending to influence Conduct of Directors by Motives other than the Promotion of the Company's Welfare.*

§ 1632. **Such Contracts while executory unenforceable Inter Partes.** — One consequence of illegality of the acceptance of bribes by directors is that any contract between a director and an outsider the tendency of which is to influence a director's official conduct by circumstances other than the good of the company is void.¹ In case of an agreement to give an outright bribe, this is abundantly clear. For instance, a contract by a person who has dealings with a corporation to pay a secret commission to a director is of course unenforceable by the director.² It is not necessary to show that in fact the contract had any improper effect upon the director: the mere tendency is enough.³

Moreover there is no necessity that the tendency of the contract to entice a fiduciary from the path of duty should be so great or so obvious. For instance, an agreement by a director and officer of a corporation so to use his official influence as to keep another person permanently in place as the company's treasurer is illegal and void, although the consideration therefor is some benefit conferred on the company and no personal gain to the director:⁴ the contract, if valid, would place the director

¹ As to whether any objection can be raised to a contract which attempts to prevent directors from exercising their judgment upon the value of property to be accepted in payment for stock, see *Electric Fireproofing Co. v. Smith*, 113 N. Y. App. Div. 615. *Stoepel*, 82 Mich. 344; 46 N. W. 724; 27 Am. St. Rep. 568; *Sargent v. Kansas, etc. R. R. Co.*, 48 Kans. 672; 29 Pac. 1063; *Lum v. McEwen*, 56 Minn. 278; 57 N. W. 662 (a superintendent and general manager, not a director); *Attaway v. Third Nat. Bank*, 93 Mo. 485; 5 S. W. 16; *Noel v. Drake*, 28 Kans. 265; 42 Am. Rep. 162; *Koster v. Pain*, 41 N. Y. App. Div. 443; 58 N. Y. Supp. 865; *Lasell v. Hannah*, 37 Can. Sup. Ct. 324, affirming *Lasell v. Thistle Gold Co.*, 11 Brit. Col. 466 (where the director was to suffer a third person to buy in obligations of the company, obtain judgment thereon, purchase the assets and transfer them to a new company, and in consideration was to receive shares in the new com-

² *Jameson v. Caldwell*, 25 Oreg. 199; 35 Pac. 245.

³ But cf. *Almy v. Orne*, 165 Mass. 126; 42 N. E. 561 (where the contract was enforced, partly upon the ground that the actual motives of the parties were honest).

⁴ *West v. Camden*, 135 U. S. 507; 10 Sup. Ct. 838. See also, as illustrations of the same principle, *Snow v. Church*, 13 N. Y. App. Div. 108; 42 N. Y. Supp. 1072; *Wilbur v.*

under a liability to a third party, unless he as director should act in a particular way; and the danger of his being influenced by a desire to escape such individual liability rather than by his unbiased opinion of what the company's welfare demands is enough to justify the law in striking down the agreement. So, a contract by a land-owner to convey certain of his real estate to an officer of a railway company in consideration of the latter's promise to aid in building up a town at that point, tending as it does to induce the officer to locate the railway so as to pass that place whether or not the location is the most beneficial for the company, is unenforceable by the director against the land-owner.¹ So, it has been held that a contract between directors of a railway by which one of them in his own name, but for their joint benefit, is to purchase land that may be sold to the company as a site for a station is tainted with suspicion and therefore unenforceable, so that the director in whose name the property is purchased cannot be required by his colleagues to account to them for their share of the profits of the transaction, except, indeed, for so much thereof as may have been due to the plaintiff's own contributions in money or services.²

§ 1633. *Contracts tending to influence a Director's Vote as Shareholder distinguished.* — On the other hand, a director may contract to use his vote as a shareholder in a particular way to the same extent as any other shareholder; and hence an agreement by a director with a person to whom he is selling certain shares to cast his (the vendor's) vote as shareholder in favor of the election of the vendee or his nominee as director is valid to the same extent as a similar contract by any shareholder who was not a director would be.³

pany); *Laughland v. Miller, Laughland & Co.*, 6 Fraser (Sc.) 413 (agreement between a director and an officer that if the latter should receive a bonus from the company the former should receive a share thereof).

Cf. *Jones v. Williams*, 37 L. R. A. 682, 690-691; 139 Mo. 1; 39 S. W. 486; 40 S. W. 353; 61 Am. St. Rep. 436 (holding that all objection is removed by the unanimous consent of the shareholders and the other

directors); *Almy v. Orne*, 165 Mass. 126; 42 N. E. 561 (similar ruling in respect to enforceability of contract to make a person a present in consideration of his acceptance of directorship).

¹ *Bestor v. Wathen*, 60 Ill. 138.

² *Cook v. Sherman*, 20 Fed. 167. Cf. *Blair Town Lot, etc. Co. v. Walker*, 50 Iowa 376.

³ *Greenwell v. Porter* (1902), 1 Ch. 530.

As to whether such a contract is

§ 1634. **Contract when executed not to be rescinded.** — If a contract to give a director a bribe or present to influence his official conduct is wholly executed and the bribe paid, the bribe-giver is not entitled to rescission of the contract and cannot recover the bribe,¹ which, as we have seen, belongs to the company.

§ 1635-§ 1647. **LIABILITIES OF DIRECTORS TO PERSONS OTHER THAN THE CORPORATION AND ITS SUCCESSORS.**

§ 1635. **Liability of Directors to One Another.** — The matter of the mutual rights of directors who have been held jointly and severally liable to the company has received some judicial consideration although not so much as could be desired for the complete elucidation of the subject. In the great and leading case, Lord Hardwicke declared that the directors who were actually concerned in fraudulent transactions were bound to reimburse their less guilty colleagues, who were liable to the company only because of negligence;² and this statement of the law seems never to have been questioned. Inasmuch as the liability of directors for breach of their official duties may be deemed too sound in contract, the doctrine of *Merryweather v. Nixan*,³ according to which contribution cannot be enforced between tortfeasors, has no application. Hence, all directors who are equally culpable in respect to any mismanagement or breach of duty are *inter sese* bound to contribute ratably according to their number towards payment of the liability to the corporation; and if the whole claim of the company has been paid by one of them he may sue the others for contribution.⁴ A director who at first vigorously opposed the breach of trust in question but finally withdrew his opposition and acquiesced therein is equally culpable with them in the eye of the law, and is therefore liable to them for contribution.⁵ But a director who was not

valid in the case of any shareholder, see supra, § 1238.

¹ *Linder v. Carpenter*, 62 Ill. 309.

² *Charitable Corp. v. Sutton*, 2 Atk. 400, 406-407.

³ *Merryweather v. Nixan*, 8 T. R. 186.

⁴ *Ramskill v. Edwards*, 31 Ch. D. 100.

100. Cf. *Ashurst v. Mason*, 20 Eq. 225; *Shepherd v. Bray* (1906), 2

Ch. 235 (compromised by agreement of parties on appeal (1907), 2 Ch.

571); *Gaither v. Bauernschmidt* (Md.), 69 Atl. 425.

⁵ *Ramskill v. Edwards*, 31 Ch. D.

present at the meeting at which an imprudent loan was resolved upon but who attended the next meeting at which the resolution was confirmed, while he may be liable to the corporation for the loss sustained, is not liable for contribution to his co-directors who concurred in the original resolution;¹ as between the several directors the loss should be borne wholly by those who were responsible for the original action. Of course, the liability of a director to his co-directors for contribution survives against his executor or administrator.²

§ 1636-§1639. *Liabilities of Directors to Individual Shareholders.*

§ 1636. **Directors not liable to Shareholders for Breach of Duty to the Corporation.** — A director's duties of care and vigilance are owed to the company alone, and not to the individual shareholders. Hence, the latter have no standing in court to complain of a director's breach of duty³ unless the circumstances are such as would entitle them to maintain a "shareholder's bill" for the wrong to the corporation.⁴ For this reason, it has been held that a pledgee of shares cannot maintain an action against the pledgor on the ground that the latter as director of the company had been guilty of mismanagement and thereby depressed the value of the security.⁵

¹ *Ramskill v. Edwards*, 31 Ch. D. 100. *Nat. Sav., etc. Co.*, 152 N. Y. 114; 46 N. E. 166.

² *Ramskill v. Edwards*, 31 Ch. D. 100, 111.

Cf. *Shepherd v. Bray* (1906), 2 Ch. 235 (compromised by agreement of parties on appeal (1907), 2 Ch. 571).

³ *Cargill v. Bower*, 10 Ch. D. 502; *Wallace v. Lincoln Savings Bank*, 89 Tenn. 630, 634-635; 15 S. W. 448; 24 Am. St. Rep. 625; *Allen v. Curtis*, 26 Conn. 456; *Niles v. New York, etc. R. R. Co.*, 176 N. Y. 119; 68 N. E. 142; *Hanna v. People's Nat. Bank*, 76 N. Y. App. Div. 224; 78 N. Y. Supp. 516; *Eldred v. Ripley*, 97 Ill. App. 503; *Smith v. Poor*, 40 Me. 415; 63 Am. Dec. 672.

Cf. *supra*, § 1134, and *Bloom v.*

But see *Davis v. Hofer*, 38 Oreg. 150; 63 Pac. 56; *Lyon v. James*, 97 N. Y. App. Div. 385; 90 N. Y. Supp. 28; affirmed in 181 N. Y. 512; 73 N. E. 1126.

⁴ See *supra*, Chapter XX.

⁵ *Palmer v. Hawes*, 73 Wisc. 46; 40 N. W. 676; *Dudley v. Armenia Ins. Co.*, 115 N. Y. App. Div. 380 (where the plaintiff was pledgor and the defendant pledgee).

But cf. *Ritchie v. McMullen*, 79 Fed. 522; 25 C. C. A. 50 (stated *infra*, § 1638).

In one case, it was said *obiter* that if officers of a company who by misconduct injure the value of a shareholder's shares and keep him in ignorance of the wrong so that he sells the shares for less than they are worth, are liable to the shareholder in damages; but in the same case it was held that if the shareholder had knowledge of the wrong at the time of selling his shares, he has no individual cause of action even though he attempted in the contract of sale to reserve all rights of action against the guilty officers.¹ The reason for this distinction is that by selling his shares he deprives himself of all redress through the company either by means of an action in the corporate name or by a shareholder's bill, so that if he parted with his shares in ignorance of his rights, it would be unjust to deny him all redress by refusing to allow him an individual cause of action. Nevertheless the only legal reason for allowing him an individual cause of action would seem to be that if he sells in ignorance of the wrong, the facts may be sufficient to sustain an action for deceit against the guilty officers on an implied representation that they had done no act to injure the value of his shares. Unless such a representation can be implied, it is difficult to sustain the dictum above referred to.² At any rate, the dictum in question even if sound does not indicate that the directors stand in any fiduciary relation toward the individual shareholder.

§ 1637. **Directors not Fiduciaries of the Individual Shareholders — Dealings between Shareholders and Directors.** — It is generally laid down that the directors stand in no fiduciary relation to the individual shareholders;³ and therefore a director in purchasing shares from a shareholder may deal at arm's length and without being subject to the stringent rules applicable to dealings by a trustee with his *cestui que trust*.⁴ In an Indiana

¹ *Rafferty v. Donnelly*, 197 Pa. Co., 4 Abb. Pr. N. S. (N. Y.) 107, St. 423; 47 Atl. 202.

² See *supra*, § 1135.

³ *Bloom v. Nat. United, etc. Co.*, 128. 152 N. Y. 114; 46 N. E. 166; *Percival v. Wright* (1902), 2 Ch. 421.

But see *Williamson v. Krohn*, 66 Fed. 655, 13 C. C. A. 668 (stated *supra*, § 414); *Stewart v. Harris*, 77 Pac. 277; 69 Kans. 498; 66 L. R. A. 261; *Karnes v. Rochester, etc. R. R.*

Cowell, 28 Pa. St. 329; 70 Am. Dec.

⁴ *Percival v. Wright* (1902), 2 Ch. 421 (where the director failed to disclose negotiations pending for a sale of the company's business); *Dead-erick v. Wilson*, 8 Baxt. (Tenn.) 108; *O'Neile v. Ternes*, 32 Wash. 528; 73 Pac. 692; *Walsh v. Goulden*, 90 N.

case where a director, having by his official position learned that the company's real financial condition was much more prosperous than the public supposed, purchased the shares of one of the shareholders at their then market value without actual fraud or misrepresentation but without revealing their real worth, the court held that the transaction could not be impeached by the vendor, since the director stood in no fiduciary relation to an individual shareholder¹ These same principles apply to non-disclosure of information acquired during negotiations for a sale of the company's entire undertaking.²

Some cases, however, tend to throw doubt on the universality of these propositions. For instance, in a comparatively early English case, the directors of a company in pursuance of a scheme to depress the price of the shares and acquire for themselves complete control of the corporation, published various false accounts in which the condition of the company was represented as much less prosperous than in fact it was. In this way certain shareholders were induced to sell their shares to the directors at an undervalue. The Lords Justices held that the directors occupied a fiduciary relation towards the shareholders, and that therefore a court of equity would rescind the sale and require the directors to account for their profits to the transferors.³ As the facts clearly showed affirmative fraud and misrepresentation, the proposition that the directors were trustees for the shareholders was doubtless not necessary to the decision, but was nevertheless the basis of the court's opinion, so that as to the *ratio decidendi* the case must now be taken to be overruled in England.

§ 1638. **Assumption by Directors of a Fiduciary Relation towards Individual Shareholders.** — Of course, directors, like promoters, while not *ex officio* fiduciaries of the several shareholders, may yet voluntarily assume such a relation. For instance, the officers of a company may declare themselves trustees of certain of their

W. 406; 130 Mich. 531; *Hooker*
Midland Steel Co., 215 Ill. 444;
74 N. E. 445; 106 Am. St. Rep.
170.

Contra: *Oliver v. Oliver*, 118 Ga.
362; 45 S. E. 232. Cf. *Morri-*
son v. Snow, 26 Utah 247; 72 Pac.
924.

¹ *Tippecanoe County v. Reynolds*,
44 Ind. 509; 15 Am. Rep. 245.

But see *Stewart v. Harris*, 77 Pac.
277; 69 Kans. 498; 66 L. R. A. 261.

² *Percival v. Wright* (1902), 2 Ch.
421, 426.

³ *Walsham v. Stainton*, 1 De G.
J. & S. 678.

shares for the benefit of certain other shareholders; and in that event they assume all the duties and disabilities of fiduciaries with respect to the latter.¹ So, if directors who are pledgees of shares in their company fraudulently mismanage the company by declining to seize advantageous opportunities for advancing its business, etc., — all for the purpose of depressing its shares in the market, and thus acquiring at a bargain the pledged shares — it has been held that they not merely violate their duty to the corporation, but also wrong the individual pledgors, who may accordingly recover damages from them.² Even, however, when the directors are express trustees for certain shareholders, their liabilities as trustees are quite distinct from their liabilities as directors. For instance, when directors hold shares in trust, their *cestui que trust* cannot proceed directly against them for mismanaging the corporation and thus reducing the value of the *cestui que trust's* interest, but must work out his rights through the medium of a shareholder's bill.³

§ 1639. **Contracts by Directors with Shareholders to perform Duties owing to the Company.** — Moreover, directors may by special contract with shareholders bind themselves to the latter to perform their duty to the corporation; and in such a case any mismanagement of the company by the directors gives a right of action to the individual shareholders.⁴ The only difficulty in such cases would lie in the possible objection that a director's promise to perform that which he is already bound to the company to perform is not a legal consideration for an assumpsit.

§ 1640-§ 1647. *Liabilities of Directors to Creditors of the Company and to other Third Persons.*

§ 1640. **In general.** — In general, it may be safely said, that directors are to be deemed, so far as their liabilities to persons other than the corporation are concerned, mere agents of the

¹ *Williamson v. Krohn*, 66 Fed. supra, § 1636); *Dudley v. Armenia* 665; 13 C. C. A. 668 (stated supra, *Ins. Co.*, 115 N. Y. App. Div. 380. § 414).

³ *Lawrence v. Curtis*, 191 Mass.

² *Ritchie v. McMullen*, 79 Fed. 240.

522, 532-535; 25 C. C. A. 50.

⁴ See *Kelley v. Collier*, 11 Tex.

But see *Palmer v. Hawes*, 73 Civ. App. 353; 32 S. W. 428. Wisc. 46; 40 N. W. 676 (stated

company. Hence, while they may be proper parties they are not necessary parties to suits by third persons against the company.¹

§ 1641. **Liability on Contracts made for the Company.** — This principle of agency leads inevitably to the conclusion that directors are not liable on contracts made by them on the company's behalf, if their directorship is disclosed to the contractor. To be sure, if the contract is beyond the scope of their authority, or *ultra vires* of the corporation, or for some other reason not binding on the company, they may like other agents be liable on an implied warranty of authority.² But if all the facts are known to the opposite party to the contract, the directors incur no liability to him because the contract is in law *ultra vires* of the corporation, and, therefore, not binding upon it.³ Moreover, if the contract is ratified or, being *ultra vires* of the corporation, is so far executed as to become binding on the company, no liability to the third person is incurred by the directors or officers who entered into the contract.⁴

§ 1642. **Liability for Failure to see that the Corporation performs a Duty or pays a Debt.** — Directors are not liable to creditors of the company, or to any persons to whom the corporation owes a duty whether arising out of contract or otherwise, for having failed to see to it that the duty is performed.⁵ For example, they are not liable personally to a shareholder whose dividends they have wrongfully withheld.⁶ Even an express oral promise

¹ Cf. *Wood v. Union Gospel, etc. Ass'n*, 63 Wisc. 9, 15 (bill to cancel stock issued illegally); *Heath v. Erie Ry. Co.*, 8 Blatchf. 347; *O'Brien v. Champlain Construction Co.*, 107 Fed. 338 (joinder of officers as parties to bill against company held not improper); *Berwind v. Van Horne*, 104 Fed. 581 (same point); *Chase v. Vanderbilt*, 62 N. Y. 307; *Brinckerhoff v. Holland Trust Co.*, 159 Fed. 191.

² Cf. *Gunther & Bro. v. Baskett Coal Co.*, 107 Ky. 44; 52 S. W. 931; (directors held individually liable to creditors for indebtedness contracted in excess of a charter limit).

³ *Abeles v. Cochran*, 22 Kans. 405; 31 Am. Rep. 194 (Brewer, J.). Cf. *Holt v. Winfield Bank*, 25 Fed. 812

(holding that officer who enters into *ultra vires* contract is not personally liable to the other party, who must be taken to have had notice of the limits of the powers of the corporation); *Fidelity & Dep. Co. v. Nat. Bank of Commerce* (Tex. Civ. App.), 106 S. W. 782.

⁴ *Linkauf v. Lombard*, 137 N. Y. 417; 33 N. E. 472; 33 Am. St. Rep. 743; 20 L. R. A. 48. Cf. *supra*, § 293.

⁵ *Wilson v. Bury*, 5 Q. B. D. 518.

⁶ *French v. Fuller*, 23 Pick. (Mass.) 108 (action against the company's treasurer); *Searles v. Gebbie*, 115 N. Y. App. Div. 778. Cf. *Williams v. Fullerton*, 20 Vt. 346 (where the action was main-

by directors to pay a debt of the corporation may be unenforceable under the Statute of Frauds.¹

§ 1643. **Liability for Torts — In general.** — On the other hand, although directors are not liable for negligent torts of subordinate agents in which they have not participated,² they are clearly liable *ex delicto* for any tort in which they participate.³ Hence, they will be liable to stockholders or creditors who have relied to their hurt upon false reports or prospectuses which the directors have published, fraudulently or (in any jurisdiction where negligent misrepresentation is actionable) negligently;⁴ and so an officer of a corporation who issues on its behalf bonds containing a representation known by him to be false will be liable to an action of deceit by any purchaser who relies thereon.⁵ So, if directors by registering a transfer of shares which they

tained against a treasurer who claimed title to the shares himself). As dividends when duly declared become an ordinary debt of the corporation, these cases are cited here rather than in the preceding division of this chapter.

¹ *Mechanics', etc. Bank v. Stettheimer*, 101 N. Y. Supp. 513; 116 N. Y. App. Div. 198.

² *Bianki v. Greater American Exhibition Co.*, 92 N. W. 615; 3 Nebr. (Unofficial) 656.

³ *Sweet v. Montpelier Savings, etc. Co.* (Kans.), 77 Pac. 538; 69 Kans. 641 (*Quære*, was not the supposed tort in this case a mere breach of contract?); *Sweet v. Montpelier Savings, etc. Co.* (Kans.), 84 Pac. 542 (directors of trust company liable to client for moneys collected by trust company for his account and mingled by them with its own funds); *Blumer v. Ulmer* (Miss.), 44 So. 161 (directors of bank held liable for inducing persons to become depositors after knowing of its insolvency, and liable in equity for prevention of multiplicity of suits although each depositor could have sued separately only at law).

⁴ *Tate v. Bates*, 118 N. Car. 287; 24 S. E. 482; 54 Am. St. Rep. 719;

Solomon v. Bates, 118 N. Car. 311; 24 S. E. 478; 54 Am. St. Rep. 725; *Houston v. Thornton*, 122 N. Car. 365; 29 S. E. 827; 65 Am. St. Rep. 699; *Lyon v. James*, 97 N. Y. App. Div. 385; 90 N. Y. Supp. 28; affirmed, 181 N. Y. 512; 73 N. E. 1126; *Warner v. James*, 88 N. Y. App. Div. 567; 85 N. Y. Supp. 153; *Yates v. Jones Nat. Bank* (Nebr.), 105 N. W. 287 (reversed as to federal questions in *Yates v. Jones Nat. Bank*, *ubi infra*, and *Yates v. Utica Bank*, 206 U. S. 181); *Smalley v. McGraw* (Mich.), 111 N. W. 1093; *J. & P. Coats v. Crossland*, 20 Times L. R. 800.

Cf. *Killen v. Barnes*, 106 Wisc. 546; 82 N. W. 536; *Mason v. Moore*, 73 Oh. St. 275; 76 N. E. 932; *Yates v. Jones Nat. Bank* (1907), 27 Sup. Ct. Rep. 638; 206 U. S. 158 (stated *infra*, § 1648). As to the liability of bank directors who by continuing to receive deposits represent to depositors that the bank is solvent, see *Nathan v. Uhlman*, 101 N. Y. App. Div. 388; 92 N. Y. Supp. 13, affirmed short in 184 N. Y. 606; *Cassidy v. Uhlman*, 163 N. Y. 380; 57 N. E. 554.

⁵ *Stickel v. Atwood*, 25 R. I. 456; 56 Atl. 687.

know to be held in trust prejudice the interest of the *cestui que trust*, they are liable *ex delicto* for assisting a trustee to commit a breach of trust; and this liability, it seems, attaches to the directors although the corporation be exempted by statute from the duty of taking notice of equitable interests in its shares.¹ Similarly, where property of an insolvent company is conveyed to a new corporation charged with payment of the debts of the old company, the directors of the new company, if they wrongfully misapply the assets, are liable in damages to the creditors of the old company.² It has been held that where a corporation infringes a patent, the officers who act only on behalf of the company cannot be held individually to account for the profits made by the infringement;³ but it is submitted that they would be liable in such a case to an action at law for damages by the owner of the patent.

§ 1644. *For Torts of Non-feasance.* — For mere non-feasance directors should not be liable to outsiders in tort;⁴ and are therefore not liable *ex delicto* to persons who rely upon fraudulent misrepresentations of other agents of the company, in which the directors have not participated.⁵ But it has been held, though with questionable soundness, that directors who have notice that certain inferior agents are converting property deposited with the company for safe keeping, and who fail to put a stop to the wrong-doing, are liable *ex delicto* to the depositor for his damages.⁶

§ 1645. *Liability to Creditors for Misconduct in Office.* — The general rule undoubtedly is that directors by lack of diligence

¹ *Société Générale de Paris v. 955; Saxlehner v. Eisner*, 147 Fed. Tramways Union Co., 14 Q. B. D. 189; 77 C. C. A. 417; *Hutter v. De 424 (semble).* *Q. Bottle Stopper Co.*, 128 Fed. 283;

² *National Bank of Jefferson v. Whiting Safety Catch Co. v. Western Texas Investment Co.*, 74 Tex. 421; *Wheeled, etc. Co.*, 148 Fed. 396. 12 S. W. 101.

³ *Cazier v. Mackie-Lovejoy Mfg. Co.*, 138 Fed. 654; 71 C. C. A. 104; *Panzl v. Battle Island, etc. Co.*, 132 Fed. 607 (reversed in part, 138 Fed. 48); *Farmers Mfg. Co. v. Sprucks Mfg. Co.*, 119 Fed. 594.

But see *Calculagraph Co. v. Wilson*, 132 Fed. 20; *Peters v. Union Biscuit Co.*, 120 Fed. 679.

Cf. *Greene v. Buckley*, 120 Fed.

⁴ *Penney v. Bryant*, 96 N. W. 1033; 70 Nebr. 127; *Cooley v. Curran*, 104 N. Y. Supp. 751.

⁵ *Arthur v. Griswold*, 55 N. Y. 400.

⁶ *United Society of Shakers v. Underwood*, 9 Bush (Ky.) 609; 15 Am. Rep. 731.

Cf. *Wolfe v. Simmons*, 75 Miss. 539; 23 So. 586.

or even by actual misfeasance in office are guilty of wrongs against the company alone. The general creditors of the corporation have no direct ground of complaint because the directors engage in *ultra vires* acts or misapply the company's funds.¹ It has, however, been held that bank directors who grossly neglect their duties of care and vigilance are liable to the depositors in an action on the case for the damage which the latter have sustained in consequence.² But it is submitted that this decision is in conflict with accepted principles of the law of agency, and would not be followed.³ A creditor whose claim is secured by a mortgage or other charge upon the company's property has, however, a property right, and any action by the directors which disregards that right may therefore amount to a tort.

§ 1646. **Relation of Directors to Persons towards whom the Company occupies a fiduciary Position.** — With respect to persons towards whom the corporation occupies a fiduciary position, the directors representing the company, sustain a like relation. Thus, where the corporation holds property in trust, a purchase of the trust property by the directors from the corporation may be regarded, so far as the *cestui que trust's* interests are concerned, as a purchase by the corporation from itself, and hence the sale would be voidable by the *cestui que trust*. In the same way, a mortgagor in possession stands in a fiduciary relation towards the mortgagee; and therefore, although a corporation (and consequently its directors) occupy no fiduciary relation towards its

¹ *Force v. Age-Herald Co.*, 136 Ala. 271; 33 So. 866; *Hart v. Evanson* (N. Dak.), 105 N. W. 942; 401; *Tate v. Bates*, 118 N. Car. 287; 24 S. E. 482; 54 Am. St. Rep. 719;

Killen v. Barnes, 106 Wisc. 546; 82 N. W. 536; *Brannin v. Loving*, 82 Ky. 370; *Gores v. Day*, 99 Wisc. 276; 74 N. W. 787 (decided under a peculiar Wisconsin statute); *Gores v. Elliott*, 108 Wisc. 465; 84 N. W. 865 (likewise turning upon the local statute).

But see *Fishel v. Goddard*, 30 Colo. 147; 69 Pac. 607.

² *Delano v. Case*, 121 Ill. 247; 12 N. E. 676; 2 Am. St. Rep. 81; affirming 17 Ill. App. 531; *Boyd v. Schneider*, 131 Fed. 223; 65 C. C. A. 209; *Foster v. Bank of Abingdon*, 88 Fed. 604 (holding a demand that the bank bring suit not a prerequisite to suit by depositor).

Cf. *Brockway Mfg. Co.*, 89 Me. 121; 35 Atl. 1012; 56 Am. St. Rep.

³ *Union National Bank v. Hill*, 148 Mo. 380; 49 S. W. 1012; 71 Am. St. Rep. 615; *Sweet v. Montpelier Savings, etc. Co.*, 69 Kans. 641; 77 Pac. 538, 541 (headnote inadequate); *Hart v. Evanson* (N. Dak.), 105 N. W. 942 (a strong judgment carefully reviewing the authorities).

general creditors, yet where the company has mortgaged its property to secure an issue of bonds it becomes a fiduciary of the bondholders. Consequently, a contract or dealing between the company and its directors which may have the effect of prejudicing the security of the bondholders will be voidable by the latter to the same extent as if the directors instead of the corporation had been the mortgagors.¹

§ 1647. **Assumption by Directors of a fiduciary Relation towards Persons dealing with the Company.** — As explained above, directors may assume a fiduciary relation towards individual shareholders, and of course, instances might be given of the voluntary assumption by directors of a fiduciary relation to other persons towards whom *virtute officii* they stand in no such position. Thus, where a corporation has by warranty deed conveyed real estate which is really subject to a vendor's lien for unpaid purchase-money, a director who subsequently assures the company's grantor that the corporation will take care of a suit by the original vendor to foreclose his lien and who thus lulls the grantee into security while his property is selling under the vendor's bill, will not be allowed as against the grantee to purchase and hold the land for his (the director's) own benefit;² being possessed of full knowledge of the transaction, and occupying a position in which he could dictate the company's policy, he had voluntarily assumed a confidential relationship to the grantee, whom the company by virtue of the covenant of warranty was legally bound to protect.

§ 1648-§ 1650. *Statutes subjecting Directors to Liabilities.*

§ 1648. **Whether statutory Liabilities are cumulative.** — The general principle is that statutes imposing new liabilities upon directors, or providing new remedies against them are to be construed as cumulative, so as not to preclude the old or common law liability of the directors to action or suit by, or on behalf of the company.³ On the other hand, the Supreme Court

¹ *McGourkey v. Toledo, etc. R. R. Water, etc. Co.*, 94 N. Y. App. Div. Co., 146 U. S. 536; 13 Sup. Ct. 170. 383; 88 N. Y. Supp. 313; *Mackie v.*

² *Allen v. Jackson*, 122 Ill. 567; *Clough*, 17 Vict. L. R. 493.

13 N. E. 840. Cf. *Excelsior Petroleum Co. v.*

³ *Loewenstein v. Diamond Soda Lacey*, 63 N. Y. 422.

of the United States has recently held that where the National Banking Act requires directors of a national bank to make certain reports to the comptroller of the treasury as to the financial condition of the institution and provides that any director who knowingly violates any provision of the law shall be liable to any person who shall have been damaged in consequence of such violation, the statutory liability is exclusive so that a director who negligently but not "knowingly" concurs in a false report to the comptroller cannot be held liable to a depositor who relies upon the report, although by the general law of the state in which the case arises negligent misrepresentation is ground for an action of deceit.¹

§ 1649. **Statutory Liabilities to Creditors.**—In the United States, statutes frequently impose very severe liabilities upon directors in favor of creditors of the company in any case where the directors have been delinquent in failing to make certain statutory reports and publications as to the company's condition,² or in paying unearned dividends,³ or in other respects.⁴ If a

¹ *Yates v. Jones Nat. Bank* (1907), 27 Sup. Ct. Rep. 638; 206 U. S. 158. Cf. *Yates v. Utica Bank*, 206 U. S. 181.

² See *Stafford v. St. John*, 73 N. E. 596; 164 Ind. 277; *MacVeigh v. Wild*, 95 Fed. 84; *Halstead v. Dodge*, 1 How. Pr. N. S. (N. Y.) 170; *Arkansas Stables v. Samstag* (Ark.), 94 S. W. 699 (enforcing statutory liability against a *feme covert* director); *Costello v. Outterson*, 112 N. Y. App. Div. 680; 98 N. Y. Supp. 880 (directors exonerated for omitting to file reports after company has ceased to do business and has suffered all its property to be sold on execution); *Hill v. Weidinger*, 110 N. Y. App. Div. 683; 97 N. Y. Supp. 473; *Squires v. Brown*, 22 How. Pr. (N. Y.) 35; *Davis v. Mills*, 194 U. S. 451; 24 Sup. Ct. 692; *Nelson v. Bank of Fergus County*, 157 Fed. 161 (applying the statute to directors of a foreign corporation).

³ See *Gaffney v. Colvill*, 6 Hill (N. Y.) 567; *Rorke v. Thomas*, 56 N. Y.

559; *Ellis v. French Canadian, etc. Ass'n*, 189 Mass. 566; 76 N. E. 207; *Appleton v. American Malting Co.*, 65 N. J. Eq. 375; *Swartley v. Oak Leaf Creamery Co.* (Iowa), 113 N. W. 496.

⁴ *Hilliard v. Lyman*, 138 Fed. 469; *Westinghouse Electric, etc. Co. v. Reed* (Mass.), 80 N. E. 621 (carrying on business before capital is paid up and certificate recorded); *American Steel, etc. Co. v. Bearse* (Mass.), 80 N. E. 623 (same liability as in last case); *Gay v. Kohlsaat*, 79 N. E. 77; 223 Ill. 260 (contracting debts in excess of capital stock and exercising corporate powers without complying with law); *Allison v. Coal Co.*, 87 Tenn. 60; 9 S. W. 226 (contracting indebtedness in excess of capital stock); *Tallmadge v. Fishkill Iron Co.*, 4 Barb. (N. Y.) 382 (contracting debts exceeding two thirds of the paid-up capital); *Lyman v. Hilliard*, 154 Fed. 339 (no remedy at law under statute making directors individually liable for debts exceeding two thirds of the capital stock);

mode of enforcing such liabilities be provided by statute, that method must be pursued; and hence if the statute contemplate a remedy by action on the case, the creditor cannot maintain a bill in equity.¹

§ 1650. **Statutory Liabilities to Shareholders.**— Sometimes, too, although more rarely, statutes are encountered which impose on directors a liability to shareholders for misconduct which reduces the value of their shares.²

§ 1651. **Liability of Shareholder or Third Person who participates in Breach of Trust by Directors.**— The liability of a shareholder or third person who participates in a breach of trust on the part of directors may be regarded as a corollary to the liability of the directors themselves. For instance, a person who employs a director as his own individual agent, and who thereby induces him to violate his duty to the corporation may be liable for abetting the breach of trust.³ Moreover, where directors have parted with the company's funds for an *ultra vires* or illegal purpose, the person to whom the payment is made if he has notice of the breach of trust is bound to refund to the company,⁴ and that too, although he has parted with some portion of the money.⁵ As stated above,⁶ this liability has been thought to rest upon the principle that the moneys of a corporation are to that extent trust funds. The question has most frequently arisen in reference to dividends paid to the shareholders out of capital.⁷ The person receiving the money is liable jointly and severally with the directors;⁸ but if the directors pay the whole claim, it seems that ordinarily they would be entitled to reimbursement from the other party, unless they had been guilty of actual fraud.⁹

Cavanaugh v. Patterson (Colo.), 91 Pac. 1117 (failure to file reports).

¹ *Legg & Co. v. Dewing*, 25 R. I. 568; 57 Atl. 373.

² See *Gaffney v. Colvill*, 6 Hill (N. Y.) 567.

³ *Brinkerhoff Zinc Co. v. Boyd*, 192 Mo. 597, 610; 91 S. W. 523 (semble).

⁴ See cases collected supra,

§ 1511. Also *Ellis v. Ward*, 137 Ill. 509; 25 N. E. 530.

⁵ *West of England Paper Mills v. Gilbert*, 61 L. J. Ch. 92.

⁶ Supra, § 1511.

⁷ Supra, § 1364—§ 1368.

⁸ *West of England Paper Mills v. Gilbert*, 61 L. J. Ch. 92. Cf. supra, § 1525.

⁹ See supra, § 1364.

CHAPTER XXVII

OFFICERS AND AGENTS

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§ 1652-§ 1653. *Application of Law of Agency to Corporations and their Agents.*

§ 1652. **In general — Agents of Corporations governed by same Principles as Agents of Individuals.** — The law which governs the relation of an ordinary agent of a corporation to the company is in all respects the same as that which would apply if the principal were a natural person. For example, the powers of an agent of a corporation transacting business within the powers of

the company are precisely the same as if the principal were an individual.¹ The law of agency controls; and, as we are now dealing with the law of corporations and not that of agency, little need be said on this subject. So far as an agent's powers may be restricted by statute or the recorded incorporation paper or articles of the company, all persons who deal with the corporation are charged with notice of the restriction;² but this principle is limited by the doctrine of the *Royal British Bank v. Turquand*, which has already been fully considered with reference to directors,³ and which applies also to inferior agents.

At one time, the liability of an individual principal for the frauds of his agent committed within the scope of his authority but without connivance by the principal was doubted; but, those doubts having been now thoroughly dissipated, as a matter of course a corporation is liable to the same extent as an individual for the frauds of agents.⁴ The same is true with respect to torts involving malice, express or implied.⁵ The metaphysical difficulty, that a corporation having no mind could have no fraudulent or malicious intent, is now a toothless giant, so that at present the liability of a corporation for the torts or contracts of its agents is, without exception, the same as that of an individual principal in the same situation.

§ 1653. **Doctrine of Ultra Vires.** — To be sure, to some extent the application of the law of agency is excluded by the doctrine of *ultra vires*. According to the severest form of that doctrine, which prevails in England, all actions of the directors or shareholders of a corporation, and *a fortiori* of its mere agents, which lie outside the powers of the company as limited by the incorporation paper, are void as corporate acts. This limitation grows out of the law of *ultra vires*, which is elsewhere treated,⁶

¹ *Merchants' Nat. Bank v. Nichols & Shepard Co.*, 79 N. E. 38; 223 Ill. 41; 7 L. R. A., n. s. 752; *New York, etc. R. R. Co. v. Dixon*, 114 N. Y. 80.

² *Supra*, § 161.

³ *Supra*, § 1473-§ 1476.

⁴ *Barwick v. English Joint Stock Bank*, L. R. 2 Ex. 259; *Mackay v. Commercial Bank of New Brunswick*, L. R. 5 P. C. 394; *Shaw v. Port Philip Mining Co.*, 13 Q. B. D.

103; *Lamm v. Port Deposit Co.*, 49 Md. 233; 33 Am. Rep. 246; 1 Bigelow on Fraud 246.

⁵ *Citizens' Life Ass. Co. v. Brown* (1904), A. C. 423 (libel); *Empire Steam Separator Co. v. De Laval Dairy Supply Co.* (N. J.), 67 Atl. 711 (slander). See *supra*, § 1072; Cook on Corporations, 5th ed. § 15 b.

⁶ *Supra*, Chapter XVI.

and need not be again taken up. There is, moreover, a presumption that the authority of an agent does not exceed the powers of the corporation itself.¹

§ 1654-§ 1673. OFFICERS.

§ 1654-§ 1660. *Who are Officers.*

§ 1654. **In general — Definitions.** — A class of agents peculiar to corporations are “officers.” This term is not altogether sharp and clear, and is very difficult to define. It connotes a certain amount of dignity and permanence of tenure. Said Lord Justice Lindley: “To be an officer there must be an office, and an office imports a recognized position with rights and duties annexed to it.”² So, Lord Justice Rigby said, “An officer must hold office. I do not mean to say that he cannot be removed, but he must be removed upon just cause.”³ But in this latter statement it would seem that the learned judge went too far: a person may hold office although liable to be dismissed at pleasure.⁴ No single criterion can be found for discriminating between an officer and a mere employee. One must rest content with the somewhat indefinite assertion that “office imports a recognized position with rights and duties annexed to it,” and with a degree of dignity and importance that a mere servant or employee does not enjoy.⁵

§ 1655. **Auditors.** — For example, a mere auditor employed by a corporation, either regularly or on special occasions is *prima facie* a servant or employee, and not an officer.⁶ But if the regulations of the company create and recognize auditorships as established, salaried positions, the occupants are officers.⁷

§ 1656. **Solicitors.** — The same law applies to solicitors. *Prima facie*, they are not officers,⁸ the company consults them

¹ Supra, § 1019.

⁵ See infra, § 1657.

² *Western Counties Steam Bakeries, etc. Co.* (1897), 1 Ch. 617, 627.

⁶ *Western Counties Bakeries* (1897), 1 Ch. 617.

³ Ibid. p. 631. So also, *Commonwealth v. Christian*, 9 Phila. 556, 558.

⁷ *Kingston Cotton Mills* (1896), 1 Ch. 6; *Kingston Cotton Mills*, No. 2 (1897), 2 Ch. 279, 283; *London and General Bank* (1895), 2 Ch. 166.

⁴ Cf. *Vincenheller v. Reagan*, 64 S. W. 278; 69 Ark. 460; *Field v. Girard College*, 54 Pa. St. 233.

⁸ *Carter's Case*, 31 Ch. D. 496; *Great Wheal Polgroth*, 49 L. T. 20;

only when it wishes, and they have no recognized, vested right to act on its behalf. Probably, not even the payment of an annual retainer would alter their position. But if the position of solicitor is provided for in the company's regulations, a fixed salary being attached, out of which he is to pay office expenses such as clerk-hire, etc., he is an officer.¹

§ 1657. **Miscellaneous Examples.** — The distinction between an officer and a servant or employee is not very sharp in theory, and is naturally difficult to apply in practice. The following have been held to be "officers": — members of a "liquidating committee,"² a "voluntary liquidator,"³ and even a bookkeeper.⁴ On the other hand, the following have been held not to be comprised within the term: — a "travelling agent" or solicitor of an insurance company,⁵ a locomotive engine-driver,⁶ a local "managing agent" of a foreign corporation,⁷ a "general agent,"⁸ and even a "general manager."⁹ A "managing director" is an officer and not a "person in the employment of the company."¹⁰

§ 1658. **Bankers.** — The reasoning of the foregoing paragraphs would in itself justify the conclusion which the courts have reached that a company's banker cannot be deemed its officer.¹¹ The additional consideration that the banker is not properly an agent of the corporation, but is rather in the position of an independent contractor leads to the same result. Probably, the only circumstance which has ever suggested even a contention to the contrary is the intimate relation which in modern finance

Northern Central Ry. Co. v. Rider, 45 Md. 24. divided upon the question whether a conductor of a railway train is an officer).

But see *Ex parte Valpy*, 7 Ch. 289.

¹ *Liberator Bldg. Soc.*, 10 Times L. R. 537.

² *Wills v. James Rowland & Co.*, 102 N. Y. Supp. 386.

³ *X Company* (1907), 2 Ch. 92.

⁴ *Hunter v. Sun Mut. Ins. Co.*, 26 La. Ann. 13.

⁵ *Commonwealth v. Christian*, 9 Phila. (Pa.) 556.

⁶ *Morrison v. Grand Trunk Ry.*, 5 Ont. L. R. 38. Cf. *Leitch v. Grand Trunk Ry. Co.*, 13 Ont. Pract. Rep. 369 (where the court was evenly

⁷ *Wheeler, etc. Mfg. Co. v. Lawson*, 57 Wisc. 400; 15 N. W. 398.

⁸ *Vardeman v. Penn Mut. Life Ins. Co.*, 125 Ga. 117; 54 S. E. 66.

⁹ *Thomas F. Meton & Sons v. Isham Wagon Co.*, 4 N. Y. Supp. 215.

¹⁰ *Normandy v. Ind, Coope & Co.* (1908), 1 Ch. 84. See *infra*, p. 1365, n. 3.

¹¹ *Imperial Land Co. of Mar-seilles*, 10 Eq. 298; *General Provident Ass. Co.*, 14 Eq. 507.

sometimes subsists between a corporation and its bankers or so-called "fiscal agents."

§ 1659. **Trustee of Deed of Trust securing Bonds.** — On principle, little hesitation would be experienced in deciding that a trustee of a deed to secure bonds or debentures is not an officer of the company, even though he may receive from it remuneration for his services as trustee. He is in no respect an agent; he cannot be regarded as acting on behalf of the company but on behalf of his *cestuis que trust*, the bondholders; and the source from which his compensation is derived would seem to be immaterial. But in one case, such a trustee was held to be an officer of the corporation.¹

§ 1660. **Directors.** — In its broadest sense the term "officer" includes directors;² but as well for other reasons as because the individual directors are not agents of the company, all the powers of directors being exercisable only by the board, it is convenient to distinguish them from other officers.³ It is true that the higher officers of a corporation, such as the president, are also members of the board of directors, but their powers and duties as officers are superadded to their powers and duties as directors. The two capacities are, or may be treated as, distinct.

§ 1661. **Officers as Agents of the Company.** — The officers of a corporation, while enjoying a more dignified position than mere servants or employees, yet like the latter fall within the general category of agents as distinguished from independent contractors. Hence the possession of the company's officers is

¹ *Astley v. New Tivoli* (1899), 1 Ch. 151.

But see *Cornell v. Massey*, L. R. 8 C. P. 328, 335.

² *Eastham v. York State Telephone Co.*, 86 N. Y. App. Div. 562; 83 N. Y. Supp. 1019 (a director held to be an officer within the purview of a statute requiring pleadings of a corporation to be verified by one of its officers); *Torbitt v. Eaton*, 49 Hun (N. Y.) 209; 1 N. Y. Supp. 614; *Brand v. Godwin*, 15 Daly (N. Y.) 456; 8 N. Y. Supp. 339; 9 N. Y. Supp. 743; *U. S. v. Means*, 42

Fed. 599; *Commonwealth v. Wyman*, 8 Metc. (Mass.) 247.

³ See *Schoening v. Schwenk*, 112 Iowa 733, 738; 84 N. W. 916 (holding directors not to be officers within the meaning of a by-law of a certain corporation); *Bristol, etc. Trust Co. v. Jonesboro, etc. Trust Co.*, 101 Tenn. 545, 553; 48 S. W. 228 (stated supra, § 1411).

A "managing director," is an officer: *Best v. British & Am. Mortgage Co.*, 131 N. Car. 70 (headnote inadequate); 42 S. E. 456. See also supra § 1657.

in law the possession of the corporation; and for this reason a creditor of the company cannot garnishee the treasurer in order to reach the funds under his control.¹ On the other hand, where a statute requiring an affidavit to be made to the statement of the consideration in a chattel mortgage prescribes one form for use where the affidavit is made by the mortgagee in person and another form for use by an agent of the mortgagee, an affidavit made by an officer, such as a vice-president, of a corporation mortgage, may be deemed to be made by the mortgagee in person.² An officer does not own an interest in the company's business within the meaning of a statute entitling the owners of a business, conducted on premises which are condemned for public use, to receive compensation for the injury to the business.³

§ 1662. **Appointment and Qualifications of Officers.** — The election or appointment of officers is usually governed by the company's by-laws or internal regulations. Generally, the officers are appointed by the board of directors, although it is quite permissible to provide that they shall be elected by the shareholders.

Being mere agents of the company, officers are not required to possess any special qualifications. Thus, an officer is not necessarily, or even presumptively, a shareholder.⁴ The higher officers however, are generally required to be chosen from among the directors, and as explained above directors are often required to be shareholders.⁵

§ 1663. **Resignation of Officers.** — Like directors, officers are not in general bound to serve the full term for which they were elected. They may resign in the meantime. A resignation requires no acceptance, and is effective as soon as communicated to the other chief executive of the company, even without com-

¹ *McGraw v. Memphis, etc. R. R. Co.*, 5 Coldw. (Tenn.) 434. Cf. *supra*, § 1357, § 1642.

² *Am. Soda Fountain Co. v. Stolzenbach* (N. J.), 68 Atl. 1078.

³ *Whiting v. Commonwealth* (Mass.), 82 N. E. 670.

But cf. *Cromwell v. Willis*, 96 Md. 260; 53 Atl. 1116 (holding that officers of a corporation are engaged

in a "regular business or employment" in the county where the company's chief office is situated, so as to be liable to suit in the courts of that county).

⁴ *Florida Savings Bank v. Rivers*, 36 Fla. 575 (vice-president); *Horbach v. Tyrrell*, 48 Nebr. 514 (secretary and treasurer).

⁵ *Supra*, § 1411 et seq.

munication to the board of directors.¹ After such notice to the company, the resignation cannot be withdrawn without the company's consent.² As the resignation terminates the officer's control over books and papers belonging to the office, he cannot be punished for contempt in failing to obey a mandamus, to produce such books for inspection, which was made absolute after his resignation;³ but doubtless if the resignation were contumacious and for the purpose of defeating the object of the writ, the court would treat the resignation itself as a contempt.

§ 1664-§ 1666. *Liabilities and Disabilities of Officers.*

§ 1664. **In general — Distinction between Inferior and Superior Officers.** — Each office has, of course, powers and duties incidental to it and peculiar to itself;⁴ but with respect to their liabilities and disabilities the officers of corporations are divided into two classes, each of which is governed by general principles applicable to all its members. The inferior officers, who are not directors, are subject in the main to the same liabilities and disabilities as ordinary agents of individuals employed to discharge similar duties;⁵ and for an explanation of the same, reference is therefore made to the treatises on agency.

The higher officers, on the other hand, such as the president and vice-president, are subject not only to the burdens and incapacities of mere agents, but also to the severer accountability to which directors are held.⁶ The liabilities and disabilities of directors have already been fully treated, and for convenience' sake the cases on the liabilities and disabilities of the superior

¹ *International Bank v. Faber*, 86 Fed. 443; 30 C. C. A. 178; *Glossop v. Glossop* (1907), 2 Ch. 370.

But see *Evarts v. Killingworth Mfg. Co.*, 20 Conn. 447, 457-458 (headnote inadequate).

² *Glossop v. Glossop* (1907), 2 Ch. 370.

³ *Egilbert v. Superior Court* (Cal.), 91 Pac. 748.

Cf. *Bauter v. Superior Court* (Cal.), 91 Pac. 749 (holding that in such a case the successor, not being

party to the writ, cannot be punished for contempt in failing to produce the books).

⁴ See *infra*, § 1667-§ 1672.

⁵ See *Mowbray v. Antrim*, 123 Ind. 24; 23 N. E. 858; *Hibernia Bldg. Ass'n v. McGrath*, 154 Pa. St. 296; 26 Atl. 377; 35 Am. St. Rep. 828; *Cook v. Berlin Woolen Mill Co.*, 43 Wisc. 433.

⁶ See *Cook v. Berlin Woolen Mill Co.*, 43 Wisc. 433.

officers have been included under the same head. It only remains, therefore, to indicate briefly the few differences in respect to these matters between officers and directors.

§ 1665. **Distinction pursued — Commands of Directors as Justification for Acts of Officers.** — In the first place, the higher officers are generally *ex officio* directors. Now, a mere agent or an inferior officer may often justify conduct that is injurious to the company by proving that he acted in obedience to the commands of those having authority over him, such as a superior officer or the board of directors;¹ but, of course, this justification cannot be sustained where the officer's wrongful acts were forbidden by the company's charter or regulations, and so beyond the powers of the directors to authorize or ratify,² or where the officer confederated with the directors in perpetrating a wrong upon the company.³ On the other hand, an officer who is a member of the board of directors can under no circumstances excuse himself on any such ground. He certainly cannot escape any of the liabilities incident to his directorship because he has the additional duties and responsibilities of an officer.⁴

§ 1666. **Officers liable severally and not One for Acts of Another.** — As shown above, directors are usually jointly and severally liable; and one by inattention to duty may become liable for the misconduct of the others in which he personally had no part: but in the case of other officers each stands on his own ground. Thus, the president and the treasurer of a corporation cannot be made liable for the negligence or misfeasance of the secretary,

¹ *Joint Stock Discount Co. v. v. Mechanics' Bank of Alexandria*, 8 Eq. 381, 406 (secretary and assistant manager); *Mackie v. Clough*, 17 Vict. L. R. 493, 496 (manager paying out unlawful dividends as the "hand of the directors"). But cf. *Minor v. Mechanics' Bank of Alexandria*, 1 Pet. 46. See also *supra*, § 1546.

² *Bank of Washington v. Bar- rington*, 2 Penrose & Watts (Pa.) 27; *Seventeenth Ward Bank v. Smith*, 51 N. Y. App. Div. 259; 64 N. Y. Supp. 888; *Holmes v. Wil- lard*, 125 N. Y. 75; 25 N. E. 1083; 11 L. R. A. 170 (semble); *Minor*

1 Pet. 46; McShane v. Howard Bank, 73 Md. 135, 152 (headnote inadequate). Cf. *New Haven Trust Co. v. Doherty*, 74 Conn. 353; 50 Atl. 887.

³ *Rankin v. Bush*, 108 N. Y. App. Div. 295; 95 N. Y. Supp. 718; *McShane v. Howard Bank*, 73 Md. 135, 152 (headnote inadequate).

⁴ *Supra*, § 1546. But see *Com- mercial Bank v. Chatfield*, 121 Mich. 641; 80 N. W. 712; *Commercial Bank v. Chatfield*, 86 N. W. 1015; 127 Mich. 407.

nor is either liable for the sins of omission or commission of the other.¹

§ 1667-§ 1672. POWERS AND DUTIES OF OFFICERS.

§ 1667. **In general.** — In regard to the powers and duties of particular officers, no general rules can be laid down. The matter in each case must be determined by the by-laws or regulations of the company, and by the practice and course of dealing of the officer in question and of previous incumbents of his office. The question is one of fact. The only cases which can be governed by any legal rules as to the powers and duties of officers are (1) cases in which there is an entire failure of evidence upon the point, so that the court is called upon to decide whether any presumption exists as to the extent of the officer's powers, and (2) cases in which the officer's actual authority is more restricted than the authority which the law would infer or presume from his title, so that as regards third persons who are not aware of the restriction his powers are to be taken as co-extensive with the powers which the law regards as *prima facie* annexed to his office. Cases of this second class are, however, comparatively rare; for it seldom happens that an officer's actual authority is more limited than his presumptive authority.

On principle, it might well be held that there is no presumption as to an officer's powers, and that in any case where there is no evidence as to his actual authority the party having the burden of proof should fail. Thus, an English court held that a written agreement to act as "managing director" for a period of five years was not sufficiently definite to satisfy the Statute of Frauds unless the duties of the office be in some way specified.² The American courts do not generally take this position with respect to such offices as those of president, secretary, and treasurer in ordinary companies;³ but presumptions are recognized as to the extent of the powers and duties of officers bearing those titles, and any litigant who asserts that the powers or duties are in

¹ *North Hudson Bldg., etc. Ass'n v. Childs*, 82 Wisc. 460, 480; 52 Barb. (N. Y.) 399, 411, where the court said, "We cannot assent to the proposition that there is any grant of power in the name by which the officer is designated."

² *Alexander's Timber Co.*, 70 L. J. Ch. 767.

³ But see *Adriance v. Roome*, 52

any case either more extended or more restricted must prove the extension or restriction affirmatively. But wherever there is any evidence tending to rebut this presumption, by enlarging the powers of the officer, the decision must turn wholly on questions of fact which in actions at law are for the jury,¹ and therefore should not be relied upon as precedents in other cases. As already intimated, however, a custom or by-law restricting the powers of an officer more closely than, according to the legal presumption, his title would indicate cannot affect the rights of third persons who deal with the company without notice of the restriction.²

§ 1668. **The President.** — The chief officer in most American corporations is the president. This office seems not to be known *eo nomine* in England, where the president's functions are exercised by the "chairman of the board of directors," by the "manager," or "managing director."³ Some conflict of authority exists as to the *prima facie* extent of a president's powers. According to some authorities the duties and powers legally incident to the office are very few, the president having the right to preside at the meetings of directors but otherwise having no greater power than any other director.⁴ According to this view, the president has *ex officio* no power to act as agent for the company in making contracts on its behalf⁵ or other-

¹ *Williams v. Cheney*, 3 Gray (Mass.) 215, 219; *Fifth Nat. Bank v. Navassa Phosphate Co.*, 119 N. Y. 256; 23 N. E. 737.

Cf. *American Car & Foundry Co. v. Alexandria Water Co.* (Pa.), 67 Atl. 861.

² *Fay v. Noble*, 12 Cush. (Mass.) 1; *American Exchange Nat. Bank v. Oregon Pottery Co.*, 55 Fed. 265. See also *supra*, § 732.

³ See *Peruvian Ry. Co.*, 19 L. T. 803; *Biggerstaff v. Rowatt's Wharf* (1896), 2 Ch. 93; *Alexander's Timber Co.*, 70 L. J. Ch. 767.

⁴ *Lyndon Mill Co. v. Lyndon Institution*, 63 Vt. 581, 585; 25 Am. St. Rep. 783; 22 Atl. 575; *Life and Fire Ins. Co. v. Mechanics' Fire Ins. Co.*, 7 Wend. (N. Y.) 31 (a strong leading case); *Titus v. Cairo, etc. R. R. Co.*, 37 N. J. Law 98, 102 (with

which compare *Beebe v. George H. Beebe Co.*, 64 N. J. Law 497); *Nat. State Bank v. Virgo County Nat. Bank*, 141 Ind. 352; 50 Am. St. Rep. 330; 40 N. E. 799; *Mount Sterling, etc. Road Co. v. Looney*, 1 Metc. (Ky.) 550; *Wait v. Nashua Armory Ass'n*, 66 N. H. 581; 49 Am. St. Rep. 630; 14 L. R. A. 356; 23 Atl. 77; *Brush Electric Light, etc. Co. v. City Council of Montgomery*, 114 Ala. 433; 21 So. 960; *Risley v. Indianapolis, etc. Ry. Co.*, 1 Hun (N. Y.) 202, affirmed 62 N. Y. 240, 245; *Sampson v. Fox*, 109 Ala. 662, 671; 19 So. 896; 55 Am. St. Rep. 950.

⁵ *City Electric Street Ry. Co. v. First Nat. Exchange Bank*, 62 Ark. 33; 34 S. W. 89; 54 Am. St. Rep. 282; 31 L. R. A. 535 (executing promissory notes); *Crawford v.*

wise.¹ Many authorities, on the other hand, which are constantly increasing in number, hold that he has presumptively by virtue

Albany Ice Co., 36 Oreg. 535; 60 Pac. 14 (executing notes); *Alta Silver Mining Co. v. Alta Placer Mining Co.*, 78 Cal. 629; 21 Pac. 373 (executing mortgage); *People's Bank v. St. Anthony's R. C. Church*, 109 N. Y. 512; 17 N. E. 408 (making note); *Reeder v. Lewis & Mason, etc. Co.*, 7 Ky. L. Rep. 363 (making note); *Millville Traction Co. v. Goodwin*, 53 N. J. Eq. 448; 32 Atl. 263 (contract by street railway

company to permit a large building to be moved upon and along its tracks); *Bacon v. Mississippi Ins. Co.*, 31 Miss. 116 (borrowing on note); *Hodges v. Rutland, etc. R. R. Co.*, 29 Vt. 220 (agreement to pay compensation to a director); *Depew v. Colton* (N. J.), 46 Atl. 728 (increasing rate of interest on bond in consideration of extension of time of payment); *Walworth County Bank v. Farmers' L. & T. Co.*, 14

¹ *Johnson v. Sage*, 44 Pac. 641; 4 Idaho 758 (appointing agents); *Joel T. Bailey & Co. v. Snyder Bros.*, 61 Ill. App. 472 (confession of judgment); *Rumbough v. Southern Improvement Co.*, 112 N. Car. 751; 17 S. E. 536; 34 Am. St. Rep. 528 (admissions as to authority of another officer not evidence against company); *Sebastian v. Covington, etc. Bridge Co.*, 21 Oh. St. 451 (president not authorized to surrender franchise of exemption from taxation); *Gibson v. Goldthwaite*, 7 Ala. 281; 42 Am. Dec. 592 (paying debts); *Tulley v. Citizens' State Bank*, 18 Ind. App. 240; 47 N. E. 850 (receiving payment of debt); *Ashuelot Mfg. Co. v. Marsh*, 1 Cush. (Mass.) 507 (instituting a suit); *Bridgeport Savings Bank v. Eldredge*, 28 Conn. 556; 73 Am. Dec. 688 (authorizing voluntary appearance for corporation as defendant in litigation); *McMurray v. St. Louis Oil Mfg. Co.*, 33 Mo. 377 (confession of judgment); *Adams v. Cross Wood Printing Co.*, 27 Ill. App. 313 (confession of judgment); *Joliet Electric Light, etc. Co. v. Ingalls*, 23 Ill. App. 45 (confession of judgment); *Thew v. Porcelain Mfg. Co.*, 5 S. Car. 415 (confession of judgment); *Raub v. Blairstown Creamery Ass'n*, 56 N. J. Law 262; 28 Atl. 384; (confession of judgment); *Hodge's*

Ex'r v. First Nat. Bank, 22 Gratt. (Va.) 51 (admissions by president of bank); *Walters v. Anglo-American Mortgage, etc. Co.*, 50 Fed. 316 (consent to appointment of receiver); *Tobin v. Roaring Creek, etc. Co.*, 86 Fed. 1020 (contract to pay 10 per cent commission for obtaining a loan for the company); *New Orleans Bldg. Co. v. Lawson*, 11 La. 34 (holding that president has no authority to pay a debt on order of majority of the directors, but that money so paid cannot be recovered back if the debt was justly due); *Nesbit v. North Georgia Electric Co.*, 156 Fed. 979 (consenting to appointment of receiver, he himself having an individual interest).

Cf. *Mausert v. Christian Feigenspan* (N. J.), 63 Atl. 610 (attempt to modify formal contract under corporate seal); *Red River Line*, 115 La. 867; 40 So. 250; *Gumaer v. Cripple Creek, etc. Co.* (Colo.), 90 Pac. 81, 86 (holding that services as general manager of the business are outside the duties of the office of president and therefore not presumptively gratuitous); *Central Trust Co. v. Condon*, 67 Fed. 84, 102; 14 C. C. A. 314; *Mathias v. White Sulphur Springs Ass'n*, 19 Mont. 359; 48 Pac. 624 (not unambiguous as to the exact extent of the president's authority).

of his position a general right of superintendence over the company's affairs in the interim between meetings of the board of directors, and that his powers are presumptively those of a general manager of the business.¹ Everywhere, even where the

Wisc. 325 (sale of personal property); *Cullman Fruit & Produce Ass'n*, 155 Fed. 372 (executing lease); *Templin v. Chicago, etc. Ry. Co.*, 73 Iowa 548; 35 N. W. 634 (letting contract for construction of railway); *Koch v. Nat. Union Bldg. Ass'n*, 35 Ill. App. 465 (renewal of lease), affirmed but on different grounds in s. c. 137 Ill. 497; 27 N. E. 530; *Stanley v. Sheffield Land, etc. Co.*, 83 Ala. 260, 262 (head-note inadequate); 4 So. 34 (borrowing money); *Bliss v. Kaweah Canal Co.*, 65 Cal. 502; 4 Pac. 507 (buying and selling real estate); *Asher v. Sutton*, 31 Kan. 286; 1 Pac. 535 (selling property); *Hoyt v. Thompson*, 5 N. Y. 320 (affixing corporate seal and hypothecating property); *First Nat. Bank v. Lucas*, 21 Nebr. 280; 31 N. W. 805 (selling property); *Yellow Jacket, etc. Co. v. Stevenson*, 5 Nevada 224 (leasing property); *Schaefer v. Scott*, 40 N. Y. App. Div. 438; 57 N. Y. Supp. 1035 (executing general assignment for benefit of creditors); *Meloy v. Central Nat. Bank*, 7 Mack. (D. C.) 69, 74 (semble, execution of general assignment for benefit of creditors); *Norton v. Ala. Nat. Bank*, 102 Ala. 420; 14 So. 872 (executing general assignment for benefit of creditors); *Pacific Bank v. Stone*, 121 Cal. 202; 53 Pac. 634 (employment of special counsel); *Bright v. Metairie Cemetery Ass'n*, 33 La. Ann. 58 (employing counsel); *Third Avenue R. R. Co. v. Ebling*, 12 Daly (N. Y.) 99 (accepting surrender of lease); *Dixie Cotton Oil Co. v. Morris* (Ark.), 94 S. W. 933 (attempt to make a contract of partnership on behalf of the corporation); *First Nat. Bank v. Tisdale*, 84 N. Y. 655; *Olney v. Chadsey*,

7 R. I. 224 (releasing claims); *Bank of United States v. Dunn*, 6 Pet. 51, 59 (agreement on discounting note not to hold endorser); *Wheat v. Bank of Louisville*, 9 Ky. L. Rep. 738; 5 S. W. 305 (compromise and release of debt); *Ansley Land Co. v. H. Weston Lumber Co.*, 152 Fed. 841; *Catiron v. First Universalist Soc.*, 46 Iowa 106 (contract for erection of church by president and secretary of religious corporation); *Marine Bank v. Clements*, 3 Bosw. (N. Y.) 600 (president of insurance company attempting to endorse notes); *Westerfield v. Radde*, 7 Daly (N. Y.) 326 (purchasing goods); *Farmers' Bank v. McKee*, 2 Pa. St. 318 (agreement as to demurrage and freight); *Gould v. W. J. Gould & Co.*, 134 Mich. 515 (executing note in conjunction with secretary); *Wait v. Nashua Armory Ass'n*, 66 N. H. 581; 49 Am. St. Rep. 630; 14 L. R. A. 356; 23 Atl. 77 (employing architect to prepare plans for building); *Jackson Breving Co. v. Canton* (La.), 43 So. 454; *Fort Smith Wagon Co. v. Baker* (Ark.), 105 S. W. 591 (contract to sell all the property and business of the company).

¹ *Russell v. Washington Savings Bank*, 23 App. D. C. 308; *Iowa Nat. Bank v. Sherman*, 97 N. W. 12; 17 S. D. 396; 106 Am. St. Rep. 778; *Chicago Pneumatic Tool Co. v. Munsell*, 107 Ill. App. 344; *Cogan v. Conover Mfg. Co.* (N. J.), 65 Atl. 484; *Dunbar Box, etc. Co. v. Martin*, 103 N. Y. Supp. 91; 53 N. Y. Misc. 312 (admission of president evidence against company); *Teale v. Consolidated Amusement Company*, 102 N. Y. Supp. 666 (employment of accountants to go over company's books); *Davis v. Ed-*

stricter construction of a president's powers prevails, he is often given either expressly by the company's regulations ¹ or impliedly

wards, 41 Wash. 480; 84 Pac. 22 (waiver of notice of hearing); *George E. Lloyd & Co. v. Matthews*, 223 Ill. 477; 79 N. E. 172; 7 L. R. A. n. s. 376 and note; *Colman v. Oil Co.*, 25 W. Va. 148 (employing counsel, suing out writ of error, etc.); *Slattery v. North End Sav. Bank*, 175 Mass. 380; 56 N. E. 606; *Wagg-Anderson Woolen Co. v. Leshner & Co.*, 78 Ill. App. 678; *Stokes v. N. J. Pottery Co.*, 46 N. J. Law 237 (semble); *Smith v. Smith*, 62 Ill. 493 (semble: "when an act pertaining to the business of the company is performed by him the presumption will be indulged that the act is legally done, and is binding upon the body"); *Aaronson v. David Meyer Brewing Co.*, 26 N. Y. Misc. 655, 658 (headnote inadequate); 56 N. Y. Supp. 387; *Patterson v. Robinson*, 116 N. Y. 193; 22 N. E. 372 (burden of proving that contract was not authorized or ratified by the directors declared to rest on party who denies its validity); *Kentucky Tobacco Ass'n v. Ashby*, 9 Ky. L. Rep. 109; *Hudson River, etc. Co. v. Hanfield*, 36 N. Y. App. Div. 605; 55 N. Y. Supp. 877 (burden of proof on party denying president's authority); *Davies v. Harvey Steel Co.*, 6 N. Y. App. Div. 166; 39 N. Y. Supp. 791 (president presumed to have authority to do any act which directors could authorize or ratify); *Norman v. Loomis-Manning Filter Co.*, 108 N. Y. Supp. 261 (same point as last case); *Union Mut. Life Ins. Co. v. White*, 106 Ill. 67 (president generally authorized to bind company within its powers); *Anderson v. South Chicago Brewing Co.*, 173 Ill. 213; 50 N. E. 655 (consenting to sale of property on which corporation holds a mortgage); *White v. Elgin Creamery Co.*, 108 Iowa 522; 79 N. W. 283 (president presumed to have authority in all matters in ordinary course of business); *Bank of Minneapolis v. Griffin*, 168 Ill. 314; 48 N. E. 154 (offer of reward for information leading to arrest of defaulter); *Richmond, etc. R. R. Co. v. Snead*, 19 Gratt. (Va.) 354 (hire of slaves by railway president); *Mitchell v. Vermont Copper Mining Co.*, 67 N. Y. 280 (tender to president of amount due on shares good to prevent forfeiture); *Savings Bank of Cincinnati v. Benton*, 2 Met. (Ky.) 240 (employing counsel to appear and defend suit); *Reno Water Co. v. Lecte*, 17 Nevada 203; 30 Pac. 702 (directing institution of suit for injunction); *Boston Tailoring House v. Fisher*, 59 Ill. App. 400 (employing counsel to defend suit); *Beebe v. George H. Beebe Co.*, 64 N. J. Law 497; 46 Atl. 168 (employing counsel to defend suit); *Am. Ins. Co. v. Oakley*, 9 Paige (N. Y.) 496; 38 Am. Dec. 561 (employing counsel); *Potter v. N. Y. Infant Asylum*, 44 Hun (N. Y.) 367 (employing counsel); *Miller v. Bank of British Columbia*, 2 Oreg. 291 (confession of judgment); *Miller v. Oregon City, etc. Mfg. Co.*, 3 Oreg. 24 (confession of judgment); *Chamberlin v. Mammoth Mining Co.*, 20 Mo. 96 (confession of judgment); *Fitch v. Constantine Hydraulic Co.*, 44 Mich. 74; 6 N. W. 91; *American Exchange Nat. Bank v. Oregon Pottery Co.*, 55 Fed. 265 (executing promis-

¹ *Bogart v. New York, etc. R. Co.*, 102 N. Y. Supp. 1093; *Hadden v. Linville*, 86 Md. 210; 38 Atl. 37; *Indianapolis Rolling Mill v. St. Louis, etc. R. R.*, 120 U. S. 256; 7 Sup. Ct. 542; *Farmers' L. & T. Co. v. Mann*, 4 Robt. (N. Y.) 356.

by custom and a course of proceeding in the corporation,¹ the wider powers of a general manager of the business. Even in such cases, the powers of the president are not necessarily coextensive with the powers of the corporation or of the directors.² It has been held that a resolution of the directors "that the company execute a general assignment," without specifically deputing any one to act, authorizes the president as the chief officer of the company to execute the instrument on its behalf;³ but on the other hand in an earlier case it was held that the president is not *ex officio* agent to negotiate for sale of property which the directors have ordered to be sold without designating any agent to represent the company in the transaction.⁴

§ 1669. **The Vice-President.** — The next highest officer in American companies is the vice-president. *Prima facie*, it would seem that the only function of this officer is to replace the president in case of the latter's death, incapacity, etc.⁵ If the president

sory note); *U. S. Nat. Bank v. First Nat. Bank*, 79 Fed. 296; 24 C. C. A. 597 (indorsing negotiable paper); *Dexter Sav. Bank v. Friend*, 90 Fed. 703 (executing notes); *Chicago, etc. R. R. Co. v. Coleman*, 18 Ill. 297, 299; 68 Am. Dec. 544 ("The president is treated by the public, and made by usage, the chief officer and executive head of the corporation"); *Case v. Hawkins*, 53 Miss. 702 (entry of remittitur of judgment for a sufficient consideration); *Skinner Mfg. Co. v. Douville*, 44 So. 1014 (Fla.) (employing broker to sell real estate).

Cf. *Blen v. Bear River, etc. Co.*, 20 Cal. 602; 81 Am. Dec. 132 (where the court said that the president's authority was limited to ordinary business, and that he could not purchase property to extend its operations).

¹ *Carrington v. Turner*, 101 Md. 437; 61 Atl. 324; *Rowland v. P. P. Carroll Loan, etc. Co.* (Wash.), 87 Pac. 482; *McKinley v. Mineral Hill, etc. Co.* (Wash.), 89 Pac. 495; *Marshall v. Columbia, etc. Street Ry. Co.*, 73 S. Car. 241, 253; 53 S. E. 417; *Jones v. Williams*, 37

L. R. A. 682; 139 Mo. 1; 39 S. W. 486; 40 S. W. 353; 61 Am. St. Rep. 436; *Tevis v. Hammersmith* (Ind.), 81 A. E. 614; affirmed, 84 N. E. 337; *Leroy, etc. Co. v. Sidell*, 66 Fed. 27, 31; 13 C. C. A. 308 (president authorized to make a parol contract held likewise authorized to make a modification thereof); *Missouri Pac. Ry. Co. v. Sidell*, 67 Fed. 464; 14 C. C. A. 477; *York v. Mathis* (Me.), 68 Atl. 746.

² Cf. *Frederick Milling Co. v. Frederick, etc. Co.* (S. Dak.), 106 N. W. 298 (confession of judgment against corporation). Cf. *infra*, § 1672.

³ *Rogers v. Pell*, 154 N. Y. 518; 49 N. E. 75; *Merchants' Nat. Bank v. Goddin*, 76 Va. 503 (deed of trust to secure bonds).

⁴ *Crump v. U. S. Mining Co.*, 7 Gratt. (Va.) 352; 56 Am. Dec. 116.

⁵ *Dreeben v. First Nat. Bank* (Tex.), 99 S. W. 850, 851-852; *Missouri, etc. Ry. Co. v. Faulkner*, 88 Tex. 649; 32 S. W. 883; *Chicago, etc. Ry. Co. v. James*, 22 Wisc. 194, 198.

Cf. *Allen v. Alston* (Ala.), 41 So.

be incapacitated by illness or absence from the country, it would seem that the vice-president may perform any of his duties.¹ *A fortiori*, the vice-president succeeds to all the president's powers upon the latter's death,² or resignation or refusal to act.³ But often, by express regulation or by custom, he has greater powers.⁴ Frequently, of course, corporations have two or more vice-presidents. Where a statute requires the president of the company to file certain reports under pain of severe penalties, the vice-president acting as president in the absence of the latter officer may file the report and by so doing relieves the president from liability for the statutory penalty.⁵ Where the by-laws confer upon the vice-president, in spite of his title, equal authority with the titular president, the former is competent to make an affidavit required by statute to be made by the "chief officer" of the company.⁶

§ 1670. **The Secretary.** — The secretary of a corporation is *prima facie* its recorder and ministerial officer.⁷ His duties are to record the minutes of meetings of directors and shareholders. He may properly record the acceptance of his own resignation.⁸ He is the custodian of the company's records.⁹

159; *Venner v. Denver Union Water Co.* (Colo.), 90 Pac. 623, 627 (headnote inadequate — holding vice-president an "agent" within the meaning of the law as to service of process on foreign corporation); *Lacaze & Reive v. Creditors*, 46 La. Ann. 237; 14 So. 601 (vice-president presumed to be authorized to institute legal proceedings); *Morris v. Griffith & Wedge Co.*, 69 Fed. 131 (vice-president not authorized to execute promissory notes).

¹ *Streeten v. Robinson*, 102 Cal. 542; 36 Pac. 946; *Wagg-Anderson Woolen Co. v. Leshner & Co.*, 78 Ill. App. 678, 680 (semble); *Aaronson v. David Meyer Brewing Co.*, 26 N. Y. Misc. 655; 56 N. Y. Supp. 387.

Cf. *Pond v. Nat. Mtge. & Deben-ture Co.*, 6 Kans. App. 718; 50 Pac. 973 (vice-president in absence of president held to be "chief officer" within meaning of statute as to service of process).

² *Colman v. Oil Co.*, 25 W. Va. 148.

³ *Smith v. Smith*, 62 Ill. 493 (holding that vice-president may exercise power specially vested in president by resolution of directors).

⁴ Cf. *Equitable Gas Light Co. v. Baltimore Coal Tar, etc. Co.*, 65 Md. 73 (headnote inadequate); 3 Atl. 108; *Cox v. Robinson*, 82 Fed. 277; 27 C. C. A. 120.

⁵ *Myar v. Poe* (Ark.), 95 S. W. 1005.

⁶ *Mandel v. Fidelity Trust Co.* (Ky.), 107 S. W. 775.

⁷ As to whether the secretary is a "clerk or servant," see *Cairney v. Back* (1906), 2 K. B. 746.

⁸ *Evarts v. Killingworth Mfg. Co.*, 20 Conn. 447, 457-458 (headnote inadequate).

⁹ *Smith v. Natchez Steamboat Co.*, 1 How. (Miss.) 479.

The books which contain the company's records belong to the corporation, and on the secretary's retirement from office must be surrendered to the company although he may have purchased them with his own money.¹ He is also presumptively intrusted with custody of the corporate seal,² and may properly attest or countersign documents to which it is affixed.³ Indeed, he may properly countersign unsealed contracts of the company.⁴ But although custodian of the seal he has no authority by virtue merely of the office to affix the corporate seal without the order of the board of directors or other competent authority, or to refuse to affix the seal when lawfully directed.⁵ He has no power to bind the company by contract.⁶ In order to establish such authority,

¹ *State ex rel. Newark, etc. R. R. Co. v. Goll*, 32 N. J. Law 285 (holding that the secretary has no lien on the books for the purchase money, for his services as secretary, or for the company's use and occupation of his premises while he was secretary). Cf. *Egilbert v. Superior Court* (Cal.), 91 Pac. 748 (stated supra, § 1663).

² *Evans v. Lee*, 11 Nevada 194; *Bliss v. Harris* (Colo.), 87 Pac. 1076; *Underhill v. Santa Barbara, etc. Co.*, 93 Cal. 300; 28 Pac. 1049.

³ See supra, § 488. As to the presumption arising from secretary's attestation of the seal, see supra, § 489 and § 490.

⁴ As to whether a contract or some other instrument signed by some other officer and countersigned by the secretary is presumed to be authorized by the corporation, see *City Electric Street Ry. Co. v. First Nat. Exchange Bank*, 62 Ark. 33; 34 S. W. 89; 31 L. R. A. 535; 54 Am. St. Rep. 282 (promissory note); *Crawford v. Albany Ice Co.*, 36 Oreg. 535; 60 Pac. 14 (promissory note); *Alta Silver Mining Co. v. Alta Placer Mining Co.*, 78 Cal. 629; 21 Pac. 373 (mortgage); *Joel T. Bailey & Co. v. Snyder Bros.*, 61 Ill. App. 472 (warrant to confess judgment); *Johnson v. Sage*, 44 Pac. 641; 4 Idaho 758 (appointment of agent);

Cattron v. First Universalist Soc., 46 Iowa 106 (promissory note); *People's Bank v. St. Anthony's R. C. Church*, 109 N. Y. 512; 17 N. E. 408 (promissory note), — in all of which cases the corporation was held not to be bound. In the following case, on the other hand, the company was held to be bound; *Sherman Center Town Co. v. Swigert*, 43 Kans. 292; 23 Pac. 569; 19 Am. St. Rep. 137 (contract).

⁵ Cf. *Rex v. Windham*, Cowp. 377 (where mandamus was granted against a warden of a college to compel him to affix the corporate seal to an answer on behalf of the corporation to a bill in equity, which answer had been approved by a majority of the fellows).

⁶ *Williams v. Chester, etc. Ry. Co.*, 15 Jur. 828 (parol contract of secretary held not binding on corporation, but partly on the ground that statute authorizing corporation to contract in a particular manner without use of seal had not been followed); *Winsted Hosiery Co. v. New Britain Knitting Co.*, 69 Conn. 565; 38 Atl. 310 (sale of goods); *Moshannon Land, etc. Co. v. Sloan*, 109 Pa. 532 (releasing debtor); *Fawcett v. New Haven Organ Co.*, 47 Conn. 224; *Wolf v. Davenport, etc. R. R. Co.*, 93 Iowa 218; *Read v. Buffum*, 79 Cal. 77

express or implied, some affirmative evidence is necessary.¹ The mere fact that the officer is called a secretary is not enough.

(assignment of chose in action); *Thomasson v. Grace M. E. Church*, 113 Cal. 558 (secretary of religious corporation undertaking to contract for paving of street in front of church); *Bangs v. Nat. Macaroni Co.*, 15 N. Y. App. Div. 522; 44 N. Y. Supp. 546 (promissory note in name of company not proved by proving signatures of president and secretary); *Pauly v. Pauly*, 107 Cal. 8; 40 Pac. 29; 48 Am. St. Rep. 98 (executing promissory notes); *Sears v. Illinois Wesleyan University*, 28 Ill. 183 (giving acknowledgment of indebtedness); *Famous Shoe, etc. Co. v. Eagle Iron Works*, 51 Mo. App. 66 (purchasing goods); *Neale v. Turton*, 4 Bing. 149 (accepting bills); *City Electric Street Ry. v. First Nat. Bank*, 62 Ark. 33; 34 S. W. 89; 31 L. R. A. 535; 54 Am. St. Rep. 282 (executing notes); *Crawford v. Albany Ice Co.*, 36 Oreg. 535; 60 Pac. 14 (executing notes); *Blood v. Marcuse*, 38 Cal. 590; 99 Am. Dec. 435 (assigning notes held by corporation); *First Nat. Bank v. Hogan*, 47 Mo. 472 (drawing bill of exchange); *Johnson v. Sage*, 44 Pac. 641; 4 Idaho 758 (appointing agents); *Cattron v. First Universalist Soc.*, 46 Iowa 106 (a religious corporation); *Alta Silver Mining Co. v. Alta Placer Mining Co.*, 78 Cal. 629; 21 Pac. 373 (executing mortgage); *Joel T. Bailey & Co. v. Snyder Bros.*, 61 Ill. App. 472 (confession of judgment); *People's Bank v. St. Anthony's R. C. Church*, 109 N. Y. 512; 17 N. E. 408 (mak-

ing promissory note); *Newlands v. National Employers, etc. Ass'n*, 54 L. J. Q. B. 428; *Oscar Bonner Oil Co. (Cal.)*, 89 Pac. 613; *Ross Oil, etc. Co. v. Eastham (Kans.)*, 85 Pac. 531 (no power to bind company by contract); *First Nat. Bank v. Abilene Hotel Co. (Tex.)*, 103 S. W. 1120 (secretary of Hotel Co. no power to execute promissory notes, where by-laws require all obligations to be signed both by president and secretary); *Karsch v. Pottier, etc. Co.*, 82 N. Y. App. Div. 230; 81 N. Y. Supp. 782 (where the judge said, obiter, that a secretary is not necessarily an officer, but where the context shows that all he meant was that the secretary does not necessarily have power to endorse negotiable paper); *Gould v. W. J. Gould & Co.*, 134 Mich. 515; 97 N. W. 576 (executing promissory note in conjunction with president); *Donaldson v. Orchard Crude Oil Co. (Cal.)*, 92 Pac. 1046.

But see *Leary v. Blanchard*, 48 Me. 269, 273 (where the court said, "The secretary of an insurance company is the officer whose duty it is to make and keep the records; and have the management of its affairs unless the contrary in some manner appears"); *Hastings v. Brooklyn Life Ins. Co.*, 138 N. Y. 473; 34 N. E. 289 (where the court said, "The secretary is one of the general managing agents of a corporation. . . . To waive prompt payment of a premium about to fall due is an act within the general

¹ For cases in which such evidence was produced, see *Kraniger v. People's Bldg. Soc.*, 60 Minn. 94; 61 N. W. 904 (borrowing money); *Sherman Center Town Co. v. Swiggart*, 43 Kans. 292; 23 Pac. 569; *Nebr.* 626; 56 N. W. 382 (endorsing

notes); *Beers v. Phoenix Glass Co.*, 14 Barb. (N. Y.) 358; *Talladega Ins. Co. v. Peacock*, 67 Ala. 253; *Sherman Center Town Co. v. Swiggart*, 43 Kans. 292; 23 Pac. 569; 19 Am. St. Rep. 137.

Ordinarily the secretary's statement as to the amount due the corporation from a debtor is not admissible against the company.¹ Any officer or agent whom the company may direct to perform any appropriate duties of the secretary becomes a secretary *pro hac vice*.²

§ 1671. **The Treasurer.** — The treasurer is *prima facie* charged with the duty of keeping the company's bank accounts and other funds.³ He is entitled to receive any moneys due to the corporation,⁴ and his receipt is a good discharge. He may properly leave the company's funds on deposit with its bankers or fiscal agents,⁵ but he must keep the moneys separate from his own funds.⁶ On the other hand, he has, by the weight of authority, no power to bind the company by borrowing money,⁷ making notes,⁸ drawing or accepting

powers of a secretary of a life insurance company"); *Frye v. Tucker*, 24 Ill. 180 (endorsement of note by secretary taken to be authorized unless denied by affidavit under Illinois practice); *Ludington v. Thompson*, 4 N. Y. App. Div. 117, 120; 38 N. Y. Supp. 768 (waiver of protest); *New England Marine Ins. Co. v. De Wolf*, 8 Pick. (Mass.) 56 (secretary's assent to assignment of insurance policy presumed to have been authorized by directors); *Kimball v. Goodburn*, 32 Mich. 10 (secretary authorized to execute formal release of mortgage when mortgage debt has been paid); *Fitch v. Constantine Hydraulic Co.*, 44 Mich. 74; 6 N. W. 91 (where the president united with the secretary in making agreement to arbitrate); *American Exchange Nat. Bank v. Oregon Pottery Co.*, 55 Fed. 265 (executing promissory note in conjunction with president).

As to the presumption that the corporate seal was properly affixed, see *supra*, § 490.

¹ *Johnston v. Elizabeth, etc. Ass'n*, 104 Pa. St. 394.

² *Peck v. New London Mut. Ins. Co.*, 22 Conn. 575.

³ *Pearson v. Tower*, 55 N. H. 215 (holding that minority shareholders

may enjoin directors from intrusting the funds to any other person than the treasurer); *Portage, etc. Ins. Co. v. Wetmore*, 17 Oh. Rep. 330 (as to liability of sureties on treasurer's bond).

Cf. *Taylor v. Taylor*, 74 Me. 582; *Brown v. Weymouth*, 36 Me. 414 ("The ordinary duties of a treasurer are to receive, safely keep, and disburse, under the supervision of the directors, the funds of the company").

⁴ *Danbury, etc. R. R. Co. v. Wilson*, 22 Conn. 435, 454 (calls are payable to treasurer).

⁵ *New York, etc. R. R. Co. v. Dixon*, 114 N. Y. 80; 21 N. E. 110.

⁶ *Second Avenue R. R. Co. v. Coleman*, 24 Barb. (N. Y.) 300.

⁷ *First Nat. Bank v. Council Bluffs City Water-Works Co.*, 56 Hun (N. Y.) 412; 9 N. Y. Supp. 859; *Fifth Ward Sav. Bank v. First Nat. Bank*, 48 N. J. Law 513; 7 Atl. 318; *Craft v. South Boston R. R. Co.*, 150 Mass. 207; 22 N. E. 920; 5 L. R. A. 641.

⁸ *Millward-Cliff Cracker Co.'s Estate*, 161 Pa. 157; 28 Atl. 1072; *Chemical Nat. Bank v. Wagner*, 93 Ky. 525; 20 S. W. 535; 40 Am. St. Rep. 206; *First Nat. Bank v. Council Bluffs City Water-Works Co.*, 56 Hun

bills of exchange,¹ endorsing notes or bills,² purchasing land or goods,³ selling⁴ or mortgaging property, compromising claims,⁵ assenting to an account stated,⁶ executing a release⁷ or otherwise.⁸ To be sure, in Massachusetts, the doctrine

(N. Y.) 412; 9 N. Y. Supp. 859; *Oak Grove, etc. Cattle Co. v. Foster*, 7 N. Mex. 650; 41 Pac. 522; *People's Bank v. St. Anthony's R. C. Church*, 109 N. Y. 512; 17 N. E. 408; *Pelton v. Spider Lake Sawmill, etc. Co.* (Wisc.), 112 N. W. 29; *Dreeben v. First Nat. Bank* (Tex.), 99 S. W. 850.

¹ *Atkinson v. St. Croix Mfg. Co.*, 24 Me. 171.

Cf. *Louisville Water Co v. Fullentove*, 12 Ky. L. Rep. 556. *Columbia Bank v. Gospel Tabernacle Church*, 127 N. Y. 361; 28 N. E. 29 (overdrawing account at bank).

² *Millward-Cliff Cracker Co.'s Estate*, 161 Pa. 157; 28 Atl. 1072; *Blake v. Domestic Mfg. Co.* (N. J.), 38 Atl. 241; *Wahlig v. Standard Pump Mfg. Co.*, 9 N. Y. Supp. 739; *Columbia Bank v. Gospel Tabernacle Church*, 127 N. Y. 361; 28 N. E. 29; *Pelton v. Spider Lake Sawmill, etc. Co.* (Wisc.), 112 N. W. 29.

But see *Perkins v. Bradley*, 24 Vt. 66.

As to endorsing certificates for shares owned by the company, see *Walker v. Detroit Transit Ry. Co.*, 47 Mich. 338; 11 N. W. 187 (where the endorsement was held valid).

³ *Slattery v. North End Sav. Bank*, 175 Mass. 380; 56 N. E. 606.

⁴ *Winsted Hosiery Co. v. New Britain Knitting Co.*, 69 Conn. 565; 38 Atl. 310; *Jackson ex dem. Ballou v. Campbell*, 5 Wend. (N. Y.) 572 (assigning mortgage); *Holden v. Phelps*, 135 Mass. 61; *Maroney v. Cole*, 52 N. Y. Misc. 451; 103 N. Y. Supp. 560 (assigning accounts due the company).

⁵ *Brown v. Weymouth*, 36 Me. 414, 417 (semble).

As to accepting payment other-

wise than in cash, see *First Nat. Bank v. Garretson*, 107 Iowa 196.

⁶ *Harvey v. West Side Elevated (Patented) Ry. Co.*, 13 Hun (N. Y.) 392.

⁷ *Dedham Institution for Savings v. Slack*, 6 Cush. (Mass.) 408; *E. Carver Co. v. Manufacturers Ins. Co.*, 6 Gray (Mass.) 214. So, the treasurer's admissions as to the state of an account are not admissible against the company; *Kalamazoo Novelty Mfg. Co.*, 36 Mich. 327.

But see *Davis v. Georgetown Bridge Co.*, 1 Cranch C. C. 147.

⁸ *Stevens v. Carp River Iron Co.*, 57 Mich. 427; 24 N. W. 160; *Brown v. Weymouth*, 36 Me. 414; *Slattery v. North End Sav. Bank*, 175 Mass. 380; 56 N. E. 606 (contract for construction of building by secretary of savings bank); *Jullard v. Walker*, 54 Ill. App. 517 (semble, power being expressly conferred by board of directors); *Wood's Sons Co. v. Schaefer*, 173 Mass. 443; 53 N. E. 881; 73 Am. St. Rep. 305 (contracting to pay president a salary); *Taylor v. Southerlin-Meade Tobacco Co.* (Va.), 60 S. E. 132 (making affidavit on behalf of company in attachment proceedings).

Cf. *Parmelee v. Associated Physicians, etc.*, 9 N. Y. Misc. 458; 30 N. Y. Supp. 250; *Howard v. Hatch*, 29 Barb. (N. Y.) 297 (treasurer to whom as such a mortgage is executed held authorized to foreclose); *Bristol County Sav. Bank v. Keavy*, 128 Mass. 298 (treasurer of savings bank authorized to institute suit to collect overdue note); *Golden Age, etc. Co. v. Langridge* (Colo.), 88 Pac. 1070 (letter from treasurer and director narrating proceedings of board of directors admissible against company).

has been established that a treasurer of a manufacturing or trading corporation is presumed to have authority to execute bills of exchange or promissory notes on behalf of the corporation;¹ but even in Massachusetts this doctrine is confined to treasurers of manufacturing or trading companies,² and in other states it is not recognized at all.³ Although the treasurer be intrusted with custody of the corporate seal, he has no authority to affix the same without an order from the board of directors.⁴

§ 1672. **The General Manager.** — In the majority of business corporations especially in small companies, there is an officer who acts as general manager of the business. Sometimes, "general manager" is his title; but often the function is intrusted to the officer who is called the president of the company. His powers are not limited by his title.⁵ In England, and in some of the British Colonies, a frequent title is that of "managing director." The authority of such an officer depends even more upon questions of fact than do the powers and authorities of other officers. There is great contrariety of decision as to the presumptive extent of the authority of a general manager of the business. According to some authorities, an officer who is acting as general manager of the business, whatever title he may bear, has *prima facie* powers co-extensive with those of the directors⁶

¹ *Narragansett Bank v. Atlantic Silk Co.*, 3 Metc. (Mass.) 282; *MERCHANTS' Nat. Bank v. Citizens' Gas Light Co.*, 159 Mass. 505; 34 N. E. 1083; 38 Am. St. Rep. 453 (a gas-light company); *Corcoran v. Snow Cattle Co.*, 151 Mass. 74; 23 N. E. 727; *Ex parte Estabrook*, 8 Fed. Cas. 794 (as to Massachusetts law).

laws closely limited the treasurer's authority); *Webber v. Williams College*, 23 Pick. (Mass.) 302; *Holden v. Upton*, 134 Mass. 177 (transfer of notes owned by savings bank by the treasurer).

² *Bradlee v. Warren Five Cent Savings Bank*, 127 Mass. 107; 34 Am. Rep. 351 (treasurer of savings bank); *Craft v. South Boston R. R. Co.*, 150 Mass. 207; 22 N. E. 920; 5 L. R. A. 641 (horse railroad or tramway company); *Jewett v. West Somerville, etc. Bank*, 173 Mass. 54; 52 N. E. 1085; 73 Am. St. Rep. 259 (co-operative bank); *Torrey v. Dustin Monument Ass'n*, 5 Allen (Mass.) 327 (an association for erecting a monument whose by-

³ *Blake v. Domestic Mfg. Co.* (N. J.), 38 Atl. 241; *Foster v. Ohio-Colorado, etc. Mining Co.*, 17 Fed. 130.

⁴ *Jackson ex dem. Ballou v. Campbell*, 5 Wend. (N. Y.) 572. As to the powers of custodian of the seal, see *supra*, § 1670.

⁵ *Ceeder v. Loud & Sons Lumber Co.*, 86 Mich. 541, 545; 49 N. W. 575; 24 Am. St. Rep. 134.

⁶ *Sun Printing, etc. Ass'n v. Moore*, 183 U. S. 642, 651; 22 Sup. Ct. 240 (where White, J., said, "The president or other general officer of a corporation has power

subject, of course, to be controlled and superseded by orders of the board of directors.¹ Other authorities refuse to go to this length. All would agree that his powers cannot exceed those of the directors themselves.² It is, however, impossible to reconcile the cases as to the limits of the authority of a person who is authorized to act generally as manager or superintendent of the business. He has been held to have no authority to make a general assignment for the benefit of creditors³ or to prefer certain creditors in anticipation of liquidation,⁴ or to exercise functions which are expressly intrusted to another officer.⁵ He may make an agreement to arbitrate a dispute,⁶ compromise or settle a claim in favor of the company;⁷ may issue commercial paper;⁸ transfer bills or notes by endorsement;⁹ sell or hypothecate or mortgage property of the company;¹⁰ borrow

prima facie to do any act which the directors or trustees could authorize or ratify"); *Hastings v. Brooklyn Life Ins. Co.*, 138 N. Y. 473, 479 (headnote inadequate); 34 N. E. 289; *Oakes v. Cattaraugus Water Co.*, 143 N. Y. 430; 38 N. E. 461; 26 L. R. A. 544; *Davies v. Harvey Steel Co.*, 6 N. Y. App. Div. 166; 39 N. Y. Supp. 791.

¹ As to this, see *Madison Ins. Co. v. Griffin*, 3 Ind. 277 (holding that a submission to arbitration authorized by the directors cannot be revoked by the managers of the business).

² *McLellan v. Detroit File Works*, 56 Mich. 579; 23 N. W. 321 (giving accommodation notes).

³ *First Nat. Bank v. Asheville Lumber Co.*, 116 N. Car. 827; 21 S. E. 948; *Wagg-Anderson Woolen Co. v. Leshner, etc. Co.*, 78 Ill. App. 678; *State Nat. Bank v. John Moran Packing Co.*, 68 Ill. App. 25 (where the assignment preferred certain creditors).

⁴ *Hadden v. Linville*, 86 Md. 210; 38 Atl. 37, 900.

⁵ *Twelfth Street Market Co. v. Jackson*, 102 Pa. St. 269.

⁶ *Remington Paper Co. v. London Ass. Co.*, 12 N. Y. App. Div. 218; 43 N. Y. Supp. 431.

⁷ *First Nat. Bank v. New*, 146

Ind. 411; 45 N. E. 597 (accepting assignment of judgment in settlement of claim); *East N. Y., etc. R. R. Co. v. Lighthall*, 36 How. Pr. 481 (accepting property in satisfaction of subscription to shares); *Dougherty v. Hunter*, 54 Pa. St. 380 (note accepted in satisfaction of debt).

⁸ *Bates v. Keith Iron Co.*, 7 Metc. (Mass.) 224; *Sparks v. Dispatch Transfer Co.*, 104 Mo. 531; 15 S. W. 417; 24 Am. St. Rep. 351; 12 L. R. A. 714; *Africa v. Duluth News Tribune Co.*, 82 Minn. 283; 84 N. W. 1019; 83 Am. St. Rep. 424; *Castle v. Belfast Foundry Co.*, 72 Me. 167; *Fitzgerald Const. Co. v. Fitzgerald*, 137 U. S. 98; 11 Sup. Ct. 36.

⁹ *Merrill v. Hurley*, 6 S. Dak. 592; 62 N. W. 958; 55 Am. St. Rep. 859. Contra: *Hitchings v. St. Louis, etc. Transportation Co.*, 68 Hun (N. Y.) 33; 22 N. Y. Supp. 719 (semble).

¹⁰ *Preston Nat. Bank v. Smith Middlings Purifier Co.*, 84 Mich. 364; 47 N. W. 502; *Simis v. Davidson*, 54 N. Y. Super. Ct. 235, 236 (headnote inadequate); *Nat. State Bank v. Sanford Fork, etc. Co.*, 60 N. E. 699; 157 Ind. 10.

But see *Hyde v. Larkin*, 35 Mo. App. 365; *England v. Dearborn*, 141 Mass. 590; 6 N. E. 837; *Luse*

money; ¹ purchase real or personal property; ² take a lease; ³ confess judgment; ⁴ employ counsel to institute a suit ⁵ or to defend a suit; ⁶ or generally to attend to the legal business of the company; ⁷ execute an appeal bond; ⁸ agree to waive the defence of the statute of limitations; ⁹ and generally to do anything that is in the ordinary course of the business.¹⁰ Notwithstanding the maxim *delegata potestas non potest delegari*, the business head of a corporation may employ attorneys, employees, or sub-agents in a proper case.¹¹

§ 1673. **Compensation of Officers.**—In respect to the compensation of officers, a distinction should be drawn between

v. Isthmus Transit Co., 6 Oreg. 125; 25 Am. Rep. 506.

¹ *Rosemond v. Northwestern Autographic Register Co.*, 62 Minn. 374; 64 N. W. 925; *Africa v. Duluth News Tribune Co.*, 82 Minn. 283; 84 N. W. 1019; 83 Am. St. Rep. 424; *Castle v. Belfast Foundry Co.*, 72 Me. 167; *Simis v. Davidson*, 54 N. Y. Super. Ct. 235 (headnote inadequate).

But see *Hyde v. Larkin*, 35 Mo. App. 365; *Western Nat. Bank v. Armstrong*, 152 U. S. 346; 14 Sup. Ct. 572 (as to powers of vice-president, acting as "general manager" of a national bank).

² *Castle v. Belfast Foundry Co.*, 72 Me. 167.

³ *Hawley v. Gray Brothers, etc. Co.*, 106 Cal. 337; 39 Pac. 609.

⁴ *Chicago Tire Co. v. Chicago Nat. Bank*, 176 Ill. 224; 52 N. E. 52; *Atwater v. Am. Exchange Bank*, 152 Ill. 605; 38 N. E. 1017; *Ford v. Hill*, 92 Wisc. 188; 66 N. W. 115; 53 Am. St. Rep. 902.

⁵ *Trustees of Smith Charities v. Connolly*, 157 Mass. 272; 31 N. E. 1058; *Reno Water Co. v. Leete*, 17 Nevada 203; 30 Pac. 702; *Lucky Queen Mining Co. v. Abraham*, 26 Oreg. 282; 38 Pac. 65; *Mumford v. Hawkins*, 5 Denio (N. Y.) 355.

⁶ *Sarmiento v. Davis Boat, etc.*

Co., 105 Mich. 300; 63 N. W. 205; 55 Am. St. Rep. 446; *Oakley v. Working Men's Union Benev. Soc.*, 2 Hilton (N. Y.) 487 (entering appearance for corporation); *Savings Bank of Cincinnati v. Benton*, 2 Met. (Ky.) 240; *Boston Tailoring House v. Fisher*, 59 Ill. App. 400; *Dallas, etc. Cold Storage Co. v. Crawford*, 18 Tex. Civ. App. 176; 44 S. W. 875; *Beebe v. George H. Beebe Co.*, 64 N. J. 497; 46 Atl. 168.

⁷ *Lewis v. Pulitzer Pub. Co.*, 77 Mo. App. 434; *Dublin, etc. Ry. Co. v. Ackerman* (Ga.), 59 S. E. 10 (employing counsel to participate in litigation to which the company is not a party, but in which it is interested).

⁸ *Sarmiento v. Davis Boat, etc. Co.*, 105 Mich. 300.

⁹ *Wells, Fargo & Co. v. Enright*, 127 Cal. 669.

¹⁰ *Heinze v. South Green Bay, etc. Co.*, 109 Wisc. 99; 85 N. W. 145; *Indianapolis Rolling Mill v. St. Louis, etc. R. R.*, 120 U. S. 256; 7 Sup. Ct. 542 (modifying or terminating contracts); *Cushman v. Cloverland Coal, etc. Co.* (Ind.), 83 N. E. 390 (employing physician to attend injured employee).

¹¹ *Streeten v. Robinson*, 102 Cal. 542; 36 Pac. 946; *Bates v. Keith Iron Co.*, 7 Mete. (Mass.) 224.

those officers who are also directors and those who are not. The latter are generally to be treated like mere agents or servants: they are entitled to a fixed salary if any is provided by company's regulations or, either expressly or impliedly, agreed upon between the parties. If no fixed salary is provided for or agreed upon, such officer is entitled to a reasonable compensation unless a mutual intention that he shall serve gratuitously be affirmatively proved. One or two cases lay down the rule that if the officer is a stockholder, although not a director, he is presumed to render his services gratis, and cannot recover compensation without a clear stipulation therefor; but this view is not supported by the authorities generally.¹ If, however, a director acts as officer — as president, vice-president, secretary, treasurer, or the like — such services to the corporation are deemed merely incidental to his duties as director, and cannot be recovered for, in the absence of express provision or stipulation.² He must content himself with the salary, if any, to which he is entitled as director. A vice-president who performs the duties of the president during the latter's illness is not entitled to the salary attaching to the office of president³ in the absence of some express provision.

¹ *Roseborough v. Shasta River Canal Co.*, 22 Cal. 556; *Huntington Fuel Co. v. McIlwaine* (Ind.), 82 N. E. 1001.

² *Supra*, § 1504.

³ *Brown v. Galveston Wharf Co.*, 92 Tex. 520; 50 S. W. 126.

CHAPTER XXVIII

BONDS AND MORTGAGES — IN GENERAL

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§ 1674-§ 1689. INTRODUCTORY AND GENERAL.

§ 1674. **Practice of raising working Capital by Issue of Bonds or Debentures.** — According to the theory of our law, the capital of a corporation is to be obtained from the issue of shares, the borrowing powers being resorted to only in emergencies; but, in practice, the company's working capital is often raised in large measure by the issue of bonds or debentures. In other words, the business is conducted with borrowed capital. This practice is becoming constantly more general. In former years, in America it was confined almost entirely to railway companies; but nowadays it is resorted to with increasing frequency by industrial corporations. In England, the practice is even more general and has been common in the case of mere industrial companies for a longer period than with us, so that upon some branches of the law of this subject English decisions are as yet the only available precedents, the points having not yet arisen in America. Under these circumstances, the nature of corporate bonds or debentures ought to be carefully considered, as well as the points of resemblance and difference between the ordinary American "bonds" and the English "debentures."

§ 1675. **Power to borrow, etc., to be assumed.** — We shall not at this time consider or discuss the general power of corporations to borrow money, to issue evidences of indebtedness, and to create mortgages or charges on their property and rights. We shall assume that these powers exist.¹

¹ As to the correctness of this assumption, see *supra*, § 69.

§ 1676-§ 1687. NATURE OF BONDS AND DEBENTURES.

§ 1676. **Bonds or Debentures as mere Evidences of Indebtedness.** — Although the ordinary bonds or debentures have now become a thoroughly well-recognized form of corporate security, yet in law their holders are nothing but secured creditors. A bond or debenture is a mere evidence of indebtedness, like an individual's promissory note. It is not, like a share of capital stock, something peculiar to incorporated companies, depending for its fundamental nature on the law of corporations. It is a mere contract, and its holder a mere creditor.¹

§ 1677. **Consequences of the corporate Character of the Debtor.** — The fact that the debtor is a corporation is, so far as the fundamental legal nature of the security is concerned, a mere accident. For creditors of a corporation occupy towards the company, in the main, precisely the same relation that the creditors of an individual occupy towards their debtor. To be sure, the American books contain much loose talk about the property of a corporation as a "trust-fund" for the payment of its debts. But the courts very generally have come to recognize that expression to be a mere figure of speech. At all events, the authorities are pretty well agreed that this so-called trust-fund theory has no application so long as the company continues to be a going concern, and consequently a consideration of that theory of corporate liabilities belongs to the law of the dissolution of corporations and would be out of place here.

§ 1678. **Consequences of the Fact that Bonds and Debentures are now a recognized Form of commercial Security.** — On the other hand, the fact that corporate bonds and debentures have by mercantile practice become a recognized form of commercial or financial security is not without legal consequences, and does, or should, in some respects sharply differentiate them from notes or other obligations of individual debtors. These points of difference it will be our special task to dwell upon. Indeed, the nature of a corporate bond or debenture as a mere evidence of indebtedness is readily capable of undue emphasis. A truly great judge, possessed of a constructive statesmanship and not merely of antique learning, — a Murray or a Shaw, — will not

¹ *Morgan v. Hedstrom*, 164 N. Y. 224; 58 N. E. 26.

hesitate boldly to except corporate bonds and debentures from rules which, however universal they have heretofore been deemed in their application to debts and mortgages, yet have little or no basis in reason as applied to these modern commercial securities.

§ 1679. **Meaning of "Bond."** — The term "bond" is a very old one, and denotes, etymologically, that which binds. It is an Anglo-Saxon translation or equivalent of the Latin "obligatio." In our law, however, it has acquired the more restricted meaning of an instrument under seal binding the maker to the payment of money. The term is often associated with bonds with a condition or defeasance, rather than with the class of instruments which we call single-bills, but of course the legal meaning of the term includes both. Where bonds are issued by corporations, they usually take a certain familiar form which now to many persons seems tied up with the very meaning of the word. According to this usage, the term is applied to instruments for the payment of money, issued in a series or group by a corporation, payable to bearer, or, if registered, to the registered holder, bearing interest payable upon the production of the interest warrants or coupons which are attached to each instrument, and secured by a so-called mortgage, or deed of trust, covering as nearly as may be all of the company's property. Other features of the ordinary corporate bond will occur to every American lawyer. The fact should not be forgotten, however, that these characteristics of the ordinary corporation bond do not in any way constitute part of the legal definition of a bond. The term "bonded indebtedness," as applied to corporations, has received judicial interpretation, and has been held to cover non-negotiable notes of a corporation.¹

§ 1680. **Meaning of "Debenture"** — *Etymologically and in England.* — In England, the designation applied to the class of corporate securities which correspond to our bonds, is "debentures." The word "debenture" is of even more general significance than "bond." It is derived from the Latin "*debentur*," with which word ancient acknowledgments of indebtedness often commenced. The word means, therefore, according to some authorities, any "document which either creates a debt or acknowledges it."² The ordinary English debentures are, like

¹ *Underhill v. Santa Barbara, etc.* ² *Levy v. Abercorris Slate Co.*,
Co., 93 Cal. 300, 308-309; 28 Pac. 37 Ch. D. 260, 264, per Chitty, J.
1049.

our bonds, issued in a series ranking *pari passu* with one another; but a debenture may consist of a single document.¹ And a debenture may be either secured or unsecured, under seal or not under seal.² Of course the term is used in a much narrower signification among both business men and lawyers as applied to the marketable debentures of English companies such as are dealt in on the stock exchange. The point is, however, that this usage is a popular one, not sanctioned by the legal definition of the term. When told that an instrument is a debenture, a lawyer learns very little about it. He must look further and see what its real nature is.

§ 1681. *In America.* — In America, the word “debenture” is not in very general use. Instruments called by that name are sometimes found, but they are not sufficiently common to give any very definite meaning to the word. It has sometimes been used to denote an instrument in the nature of a promissory note issued by a corporation secured by a pledge of certain particular assets.³

§ 1682–§ 1687. *Comparison of English Debentures with American Bonds.*

§ 1682. **Similarity of the two Classes of Securities.** — The ordinary debentures of English companies approximate very closely to the ordinary American corporate bond. That is to say, the ordinary English debentures are, like our bonds, issued in series all of which rank *pari passu* with one another without priority by reason of date or otherwise. They are likewise freely transferable, being payable to bearer, or to the registered holder for the time being. They carry interest at a fixed rate payable upon the production of coupons or interest-warrants which are attached to the debentures. So, too, both English debentures and American bonds are secured by a mortgage, or charge in the nature of a mortgage, covering all or practically all the company's property, and having the same general object, namely, to enable the company to carry on its business as though the incumbrance

¹ *Edmonds v. Blaina Furnace* § 776, pp. 2098–2099. Cf. *Washburn v. National Wall Paper Co.*, 81 Fed. 17; 26 C. C. A. 312 (relating to so-called “debenture-stock” issued by a New York corporation).

² *British India, etc. Co. v. Inland Revenue Comm'rs*, 7 Q. B. D. 165.

³ Cook on Corporations, 5th ed.

did not exist and yet to give the debenture-holders or bondholders a priority over the general creditors in the distribution of the company's assets in case the business proves a failure.

§ 1683. **English Floating Charge.**—In England this latter object is attained by means of what is known as a "floating charge."¹ That is, the company charges all its property and rights, present and future, and its business or undertaking, for the payment of the debentures, principal and interest. As to after-acquired property, the charge cannot take effect as a legal conveyance but it will be enforced in equity. If the charge were to operate like an ordinary mortgage, the company would be unable to convey a clear title to any customer with whom it might deal, and its business would be paralyzed. This would defeat the obvious intent of the parties. Accordingly, the charge is held to be subject to the power of the company to deal with its property in the ordinary course of business as if the debentures had never been issued; and this power of the company continues until the charge becomes, as the phrase is, crystallized, by the appointment of a receiver, the liquidation of the company, or in other ways hereinafter mentioned. Until this crystallization of the charge, the company may manage and dispose of its property as though the incumbrance had never been created. Upon crystallization, the charge attaches to whatever property the company then possesses, so as to give the debenture-holders a priority over unsecured creditors.² Before the charge becomes fixed and while it is floating merely, it is a present equitable charge, subject to a power in the company to carry on its business in ordinary course.³

¹ As to what is a floating charge see, in addition to cases cited below, *Illingworth v. Houldsworth* (1904), A. C. 355.

² *Panama, etc. Mail Co.*, 5 Ch. 318; *General South American Co.*, 2 Ch. D. 337.

In a comparatively early case, *Russell v. East Anglian Ry. Co.*, 3 Mac. & G. 124, 144, the legality of a floating charge seems to have been doubted, upon the ground that it might operate as a fraud on the general creditors; but this doubt seems unfounded in principle

and has never troubled the courts further. Buckley, J., has recently expressed the opinion that an English "floating charge" works injustice to general creditors, *London Pressed Hinge Co.* (1905), 1 Ch. 576, but it should be observed that the "injustice" of which the learned judge speaks could be avoided by the application of the American rule established in the leading case of *Fosdick v. Schall*, and explained *infra*, § 1932 et seq.

³ *Wallace v. Evershed* (1899), 1 Ch. 891, 894; *Driver v. Broad*

§ 1684. **American Expedient for accomplishing the same Object as a Floating Charge.** — Thus we see that the English floating charge is a very clever automatic device for securing to the debenture-holders a priority over general creditors in respect to any and all assets of the company, without, however, interfering with the company's power to carry on its business as if the incumbrance did not exist. The same object has been attained, or approximately attained, in the case of ordinary American corporation bonds by the clumsier expedient of giving to the trustees of the covering deed or mortgage a power to consent to any disposition that the company may desire to make of the property charged. This expedient has proved sufficiently satisfactory in the case of railroad companies where the property charged consisted chiefly of real estate or chattels of a permanent character. But in the case of an issue of bonds by an industrial corporation, if the security of the bondholders is to include the company's shifting stock-in-trade, manufactured products, etc., — as is of course desirable, — a power must be given to the company of carrying on its business in the ordinary course which will make the charge or mortgage practically identical with the usual English floating charge. Accordingly, we find that as the practice of issuing bonds by industrial, manufacturing, and trading corporations becomes constantly more general, the charge by which they are secured approximates more and more closely to an English floating charge. The prediction is ventured that before many years have passed, the security of our industrial bonds will be recognized as identical, or nearly so, with the English floating charge; and that then perhaps the verbiage of the usual American corporation deed of trust or mortgage will

(1893), 1 Q. B. 744 (headnote inadequate). Said Ray, L. J., in the case last cited: "It (the term 'floating charge') does not mean that there is not to be a charge, and an immediate charge, on the property, but merely that, notwithstanding the existence of the charge on all the property, including the real property, of the company, power is reserved to dispose of the property if in the ordinary course of carrying on the company's business it becomes necessary to do so. The

charge is none the less a charge because such a power is reserved." (1893), 1 Q. B. 749.

Note, however, that a subsequent equitable mortgage to a creditor who had no notice of a clause in previously issued debentures prohibiting mortgages of specific assets from displacing the lien of the debentures, may nevertheless be postponed to the debentures: *Valletort Sanitary Steam Laundry Co.* (1903), 2 Ch. 654.

give place to the simple, direct language by which an English company creates a floating charge as security for its debentures. At all events, the resemblance between the two classes of security is sufficiently close, particularly in view of the comparative paucity of American decisions upon the subject of bonds of industrial corporations, to render a careful examination and explanation of the English cases desirable.

§ 1685. **How Charge or Mortgage is created — Whether by a Clause in the Bonds or Debentures themselves or by a separate Deed or Mortgage.** — In England, the floating charge is often created by and contained in the debentures themselves. For instance, a declaration in a debenture that the company charges its undertaking, and all its property and effects, with the payment of the debenture will create a floating charge.¹ This is possible because in England there are no Recording Acts similar to those in force in the United States. It would obviously be impracticable in America because each bond or debenture would, if it contained a charge or mortgage, require to be recorded;² and the expense as well as the cumbersomeness of this procedure would prove a serious obstacle. Even in England, the practice is not uncommon of executing a covering deed of trust in the nature of a mortgage to secure a whole series of debentures.

§ 1686. **Necessity for Registration of Mortgage or Charge.** — We have already referred to the fact that in England there are no Recording Acts similar to our own. The Bills of Sales Acts do require registration of certain conveyances of chattels; but these acts have been held to have no application to debentures of corporations formed under the Companies Acts,³ or to deeds of trust to secure such debentures.⁴ On the other hand, provision was made by the Companies Act of 1862 for the keeping of a register of all mortgages and charges by companies incor-

¹ *Panama, etc. Mail Co.*, 5 Ch. 318, 322.

² But see *White Water, etc. Canal Co. v. Vallette*, 21 How. 414, where a pledge of real and personal property contained in bonds issued by a canal company was held valid in equity, no objection being made on the score of non-compliance with recording acts.

³ *Standard Mfg. Co.* (1891), 1

Ch. 627; *Campbell v. Harrison*, 3 N. So. Wales State Rep. 432; *Read v. Joannon*, 25 Q. B. D. 300; *Clark v. Balm, Hill & Co.* (1908), 1 K. B. 667.

Cf. *Great Northern Ry. Co. v. Coal Co-operative Soc.* (1896), 1 Ch. 187.

⁴ *Richards v. Overseers of Kidderminster* (1896), 2 Ch. 212.

porated under that statute.¹ A failure to keep such a register, although a breach of duty on the part of the company, did not invalidate unregistered debentures² even when issued to a director whose duty it was to see that the register was properly kept.³ Moreover, a register kept in accordance with these provisions was not a public register, of which all the world has constructive notice: it was not open to the public or even to persons who might contemplate lending money to the company, or otherwise dealing with it, but only to shareholders and existing creditors.⁴ This state of the law was very unsatisfactory; and accordingly by the Companies Act of 1900 it is now provided that every mortgage or charge for the purpose of securing an issue of debentures shall be void unless filed or registration with the registrar of joint-stock companies, whose register is to be open to inspection by anybody upon payment of a small fee.⁵ This statute does away with the injustice of permitting the holders of debentures, of the existence of which the general creditors may have been unaware, to step in when the company comes to grief and exclude the general creditors from equal participation in the assets, and places the English law in respect to the registration of charges, upon somewhat the same footing as that which under the Recording Acts generally prevails throughout the United States.⁶ Under this English statute,

¹ 25 & 26 Vict. c. 89, § 43.

² *General South American Co.*, 2 Ch. D. 337.

³ *Wright v. Horton*, 12 A. C. 371. The contrary was formerly held: *Dublin Drapery Co.*, 13 L. R. Ir. 174; *Native Iron Co.*, 2 Ch. D. 345.

⁴ *Wright v. Horton*, 12 A. C. 371.

⁵ 63 & 64 Vict. c. 48, § 14; *Illingworth v. Houldsworth* (1904), A. C. 355. For other cases arising under this statute, see *Anglo-Oriental Carpet Mfg. Co.* (1903), 1 Ch. 914; *Harrogate Estates* (1903), 1 Ch. 498; *Cornbrook Brewery Co. v. Law Debenture Corp.* (1904), 1 Ch. 103 (distinguished in *Bristol United Breweries v. Abbot* (1908), 1 Ch. 279); *Spiral Globe* (1902), 2 Ch. 209; *Ehrmann Bros.* (1906), 2 Ch. 697; *Cardiff Workmen's Cottage Co.* (1906), 2 Ch. 627; *Jackson v.*

Bassford (1906), 2 Ch. 467 (issue of debenture in pursuance of previous unrecorded contract held a fraudulent preference); *Leicester v. Yolland*, *Husson & Birkett* (1908), 1 Ch. 152 (as to the conclusiveness of the registrar's certificate that all the requirements of law have been complied with and that the instruments are properly registered as a series).

⁶ As to the American law, see *infra*, § 1486, and *Farmers' L. & T. Co. v. Hendrickson*, 25 Barb. (N. Y.) 484; *Hunt v. Bullock*, 23 Ill. 320; *Stevens v. Buffalo, etc. R. R. Co.*, 31 Barb. 590; *Radebaugh v. Tacoma, etc. R. R. Co.*, 8 Wash. 570; 36 Pac. 460; *Manhattan Trust Co. v. Seattle Coal & Iron Co.*, 48 Pac. 333; 16 Wash. 499; *Ramsdell v. Citizens' Electric, etc. Co.*, 103 Mich. 89; 61 N. W. 275; *Farmers'*

however, the debentures or covering deeds were not copied out into the register, but the registrar noted certain particulars merely, such as the amount of the charge, the property covered, etc; but now by a recent amendatory statute, the instrument creating the charge is, as in America, required to be filed in the public registry.¹

§ 1687. **Debenture-stock.** — Debenture-stock is a form of security which is very popular in England, and bears somewhat the same relation to the corporations by which it is issued that our city stock or government stock bears to the municipal corporation or government. It is generally secured by a floating charge upon all the company's property. The most notable characteristic of debenture-stock is that any fraction of the stock may be transferred. A stock-certificate is issued to each purchaser or transferee of the stock, stating, *inter alia*, if the stock is registered, that the person named is the registered proprietor, or if it is bearer stock, that the bearer thereof is the registered proprietor of so much stock. Where the stock is registered, a transfer is effected in much the same way as a transfer of shares of capital stock. The use of the word "stock" must not, however, lead one to suppose that debenture-stock has any affinity with capital stock.² Debenture-stockholders are creditors as distinguished from members of the corporation. Debenture-stock may be either redeemable or irredeemable. If redeemable, it differs from ordinary debentures chiefly in the method of transfer. If irredeemable, it has the additional peculiarity that the company's obligation is to pay an annuity of a certain amount in perpetuity. Perpetual debenture-stock cannot be issued without express authority in the company's memorandum of association.³ Analogous securities in the

etc. Trust Co. v. St. Joseph, etc. Ry. Co., 3 Dill. 412; *Ludlow v. Clinton Line R. R. Co.*, 1 Flip. 25.

Cf. Williamson v. New Jersey Southern R. R. Co., 26 N. J. Eq. 398; *Boylan v. Kelly*, 36 N. J. Eq. 331; *New York Economical Printing Co.*, 110 Fed. 514; 49 C. C. A. 133.

A statute prescribing one method of recording for railroad mortgages is not repealed by implication by a subsequent statute prescribing a

different method for recording of mortgages by corporations in general: *Gilchrist v. Helena, etc. R. R. Co.*, 47 Fed. 593.

¹ Companies Act, 1907 (7 Edw. VII, c. 50), § 10.

² *Re Bodman* (1891), 3 Ch. 135. *Cf. Sellar v. Charles Bright & Co.* (1904), 2 K. B. 446.

³ See supra, § 74.

United States, in the case of private corporations, are so rare as to be almost unknown.¹

§ 1688. **Plan and Scope of subsequent Treatment of Subject.** — Having thus taken a brief survey of the nature of English debentures and having adverted to the most important points both of resemblance and difference between them and the American mortgage bonds, we shall proceed to consider in detail the law governing both classes of securities, which are so far similar as to admit of this treatment. Further differences between them will be noted from time to time in the course of the consideration of the subject. We shall not take up the general law of contracts, by which bonds and debentures, being contracts, are governed. Neither shall we deal with the principles of the law of negotiable paper, which have been established in reference to bills of exchange and promissory notes, although coupon bonds and debentures, being (as will presently be shown) negotiable instruments, are in general governed by the same law. Nor shall we undertake to state the law of mortgages or the general doctrines of equity applicable to trusts of all descriptions. Our task will be to set forth the peculiarities of the law of corporation bonds or debentures, — the points in which that law differs from the general law of contracts, of negotiable instruments, of mortgages, and of trusts.

§ 1689. **Sources of Peculiarities of Law of Bonds and Debentures.** — The peculiarities of the law of corporate bonds and debentures flow from four different sources: first, the fact that the obligor is a corporation;² second, the fact that the instruments are issued in a series; third, the nature of the property charged with their payment, namely, a whole business or undertaking; and, fourth, and most important of all, the fact that bonds or debentures of incorporated companies, unlike the notes or obli-

¹ See, however, *Philadelphia, etc. burn v. National Wall-Paper Co.*, 81 R. R. Co.'s Appeal, 4 Am. & Eng. Fed. 17; 26 C. C. A. 312 (relating to R. R. Cases 118. so-called "debenture-stock" issued

Cf. also *Heller v. Marine Bank*, 89 Md. 602; 43 Atl. 800; 73 Am. St. by a New York corporation).
Rep. 212; 45 L. R. A. 438; *Wash-*

² Cf. supra, § 1677.

gations of individuals or even the other obligations of corporations, are a form of commercial security used for purposes of investment and speculation.¹

§ 1690-1729. *ISSUE OF BONDS AND DEBENTURES.*

§ 1690-§ 1692. *Whether Issue of Bonds or Debentures is a Borrowing of Money.*

§ 1690. **In general.** — Bonds and debentures are, as we have already said, contracts or evidences of indebtedness. Hence the issue of them is naturally thought of as a borrowing of money by the company. But it may or may not be so. The question whether or not the issuing of debentures is a borrowing may arise in two classes of cases; first, cases in which to construe the transaction as a loan will sustain its validity; and, second, cases in which the transaction, if it be a loan, is invalid. As the very proper inclination of the courts is to construe the transaction *ut res magis valeat quam pereat*, somewhat different considerations may be applicable to the two cases.

§ 1691. **In Cases where to construe the Issue as a Loan would sustain its Validity.** — Thus, a power to borrow money on mortgage will support an issue of bonds or debentures to tradesmen in payment for goods previously sold to the company:² the transaction is equivalent to borrowing the money represented by the debentures and then applying it to the payment of the tradesmen. So, where a corporation is under a contract to indemnify P against certain debts for which he is liable, the issue of debentures to one of those creditors in satisfaction of his claim against P, being virtually a borrowing of money, may be sustained although there be no power to issue debentures except for the purpose of borrowing money.³ Moreover, under a power to borrow money on mortgage, an issue of mortgage bonds as collateral security for a pre-existing indebtedness may be sustained.⁴ But a federal court has recently expressed the

¹ *Supra*, § 1678.

Big Creek, etc. Iron Co. v. American

² *Inns of Court Hotel Co.*, 6 Ch. L. & T. Co., 127 Fed. 625; 62 C. C. 82 (headnote misleading). A. 351.

See also *Pyle Works (No. 2)* ³ *Seligman v. Prince* (1895), 2 (1891), 1 Ch. 173; *Winnipeg, etc.* Ch. 617, 624.

Ry. Co. v. Mann, 7 Manitoba 81; ⁴ *Nelson v. Hubbard*, 96 Ala.

opinion that bonds issued to pay for options and contracts transferred to the company cannot be deemed an exercise of a power to borrow money and secure the same by bond and mortgage.¹

§ 1692. **In Cases where if construed as a Loan the Issue would be invalid.** — On the other hand, the issue of bonds to a contractor in payment for work done will not be construed as a borrowing where, construed in that way, the bonds would be void under the usury laws by reason of the rate of interest agreed to be paid.² And in order to sustain the validity of bonds carrying a high rate of interest, the issue has been construed as a sale of the company's own securities rather than a loan;³ but except for the high authority of this decision, one might well question whether a corporation can in law sell its own bonds.

§ 1693-§ 1698. *Issue at a Discount.*

§ 1693. **In general.** — The issue of shares at a discount is, to say the least, discountenanced by the law; but the same reasons are not in theory applicable to an issue of bonds or debentures, which, accordingly, may, in the absence of some prohibitory statute, be issued at a discount and yet be enforceable for their face value.⁴ This is true, it seems, even to the prejudice of other holders of debentures of the same series all of which rank *pari passu* with one another.⁵ Of course, the issue of

238, 251; 11 So. 428; 17 L. R. A.

375.
¹ *Wyoming Valley Ice Co.*, 153 Fed. 787, affirmed *sub nom. Wiegand v. Lewis Lumber, etc. Co.*, 158 Fed. 608.

² *White Water, etc. Canal Co. v. Vallette*, 21 How. 414; *Memphis etc. R. R. v. Dow*, 120 U. S. 287, 300; 7 Sup. Ct. 482.

Cf. Bagnalstown & Wexford Ry. Co., Ir. Rep. 4 Eq. 505.

As to the application of usury laws to bonds and debentures, see *infra*, § 1694.

³ *Junction R. R. Co. v. Bank of Ashland*, 12 Wall. 226. *Cf. Bank of Ashland v. Jones*, 16 Oh. St. 145.

⁴ *Anglo-Danubian, etc. Co.*, 20

Eq. 339; *Campbell's Case*, 4 Ch. D. 470; *Webb v. Shropshire Rys. Co.*

(1893), 3 Ch. 307, 320, 330; *Gamble v. Queens County Water Co.*, 123 N. Y. 91, 107-108; 25 N. E. 201; 9 L. R. A. 527; *Farmers' L. & T. Co. v. Rockaway Valley R. R. Co.*, 69 Fed. 9; *Franklin Trust Co. v. Rutherford, etc. Electric Co.*, 41 Atl. 488; 57 N. J. Eq. 42; affirmed short in 43 Atl. 1098; 58 N. J. Eq. 584.

Cf. Riggs v. Pennsylvania, etc. R. R. Co., 16 Fed. 804; *Coe v. Columbus, etc. R. R. Co.*, 10 Oh. St. 372; 75 Am. Dec. 518; *Weed v. Gainesville R. R. Co.*, 119 Ga. 576; 46 S. E. 885.

⁵ *Cf. Regent's Canal Ironworks Co.*, 3 Ch. D. 43. See *infra*, § 1891.

bonds or debentures without any consideration would, unless in exceptional cases, be *ultra vires*;¹ but nevertheless bonds issued without consideration will not be decreed to be cancelled at the suit of holders of *bona fide* purchasers for value of other bonds of the same series.²

§ 1694. **Usury Laws as an Obstacle to Issue at a Discount.** — Ordinarily, the only legal obstacle to the issuance of bonds or debentures for less than par is found in usury laws.³ Whether or not the usury laws interfere depends on whether or not the debentures are issued under such circumstances as to make the transaction a loan.⁴ Hence, as indicated above, debentures carrying more than the legal rate of interest are not invalid when issued in payment for property or for work and labor.⁵ On the other hand, bonds issued at a discount in settlement of an antecedent indebtedness and carrying more than legal interest will be tainted with usury.⁶ Special acts of incorporation sometimes exempt the company from the operation of usury laws;⁷ and so too general laws sometimes prevent the defence of usury

¹ See *Kemble v. Wilmington, etc. R. R. Co.*, 13 Phila. 469.

² *Bibb v. Montgomery Iron Works*, 101 Ala. 301; 13 So. 224. But cf. *infra*, § 1891.

³ Cf. *Metropolitan Trust Co. v. Columbus, etc. R. R. Co.*, 93 Fed. 702 (where a statute authorized the issue of 7 per cent bonds at 75 per cent of their face value although the usury laws prohibited a higher rate of interest than 8 per cent).

As to the application of usury laws to the issue of bonds, see, in addition to cases cited below, *Simmons v. Taylor*, 38 Fed. 682; *George N. Fletcher & Sons Co. v. Alpena Circuit Judge* (Mich.), 99 N. W. 748; 136 Mich. 511. Where eight per cent is the highest legal rate of interest, a bond for \$1000 maturing at the end of forty years and bearing six per cent interest is not usurious although issued for a loan of \$850; the \$1000 plus the aggregate amount of interest payable

during the forty years would be less than \$850 plus interest at eight per cent, and the case is not altered because the bond contains a clause accelerating the maturity of the principal in case of a default in payment of interest: *Georgia Southern, etc. R. R. Co. v. Mercantile Trust, etc. Co.*, 94 Ga. 306, 321; 21 S. E. 701; 47 Am. St. Rep. 153; 32 L. R. A. 208.

⁴ Cf. *supra*, § 1692.

⁵ *White Water, etc. Canal Co. v. Vallette*, 21 How. 414; *Memphis, etc. R. R. v. Dow*, 120 U. S. 287, 300; 7 Sup. Ct. 482.

⁶ *Commissioners of Craven v. Atlantic, etc. R. R. Co.*, 77 N. Car. 289.

⁷ *Junction R. R. Co. v. Bank of Ashland*, 12 Wall. 226, 230; *White Water, etc. Canal Co. v. Vallette*, 21 How. 414, 425; *Morrison v. Eaton, etc. R. R. Co.*, 14 Ind. 110; *Traders' Nat. Bank v. Lawrence Mfg. Co.*, 96 N. Car. 298; 3 S. E.

from being set up by a corporation or by any person claiming under it.¹

§ 1695. **Statutes providing that Bonds shall not be issued except in Exchange for Money, Labor, or Property, etc.** — In the United States, statutes sometimes provide that bonds as well as shares of capital stock shall not be issued by corporations except in exchange for money, labor, or property, and that all fictitious increase of bonded indebtedness shall be void.² Such a provision does not invalidate the *bona fide* issue of bonds in pursuance of a reorganization agreement although the value of the property received therefor did not in fact equal the par value of the bonds.³ It does, perhaps, prohibit an issue as collateral security for a pre-existing indebtedness,⁴ but does not forbid a pledge of bonds for a contemporaneous advance merely because the amount of the advance may be less than the face value of the bonds.⁵ Some cases construing such provisions apparently

¹ *Lembeck v. Jarvis, etc. Storage Co.*, 92 Fed. 428; 34 C. C. A. 431.

² Provisions of this sort have been construed in numerous cases. See in addition to those cited below, *Hinckley v. Pfister*, 83 Wis. 64; 53 N. W. 21; *Pfister v. Milwaukee, etc. Ry. Co.*, 83 Wis. 86; 53 N. W. 27; *New Castle Northern Ry. Co. v. Simpson*, 21 Fed. 533; *Waterloo Organ Co.*, 134 Fed. 341; 67 C. C. A. 255; *Childers v. Shepherd*, 39 So. 235; 142 Ala. 385 (where an issue of bonds in excess of a certain amount was enjoined); *Re Snyder*, 29 N. Y. Misc. 1; 59 N. Y. Supp. 993; *Hudson River, etc. R. R. Co. v. Hanfield*, 36 N. Y. App. Div. 605; 55 N. Y. Supp. 877 (bonds issued to contractor in advance of performance valid); *Wyoming Valley Ice Co.*, 153 Fed. 787 (bonds to the amount of \$90,000, and stock to the amount of \$200,000 issued for \$27,500 worth of property held invalid in the hands of original holders), affirmed *sub nom. Wiegand v. Lewis Lumber Co.*, 158 Fed. 608.

³ *Memphis, etc. R. R. v. Dow*, 120 U. S. 287; 7 Sup. Ct. 482; *Sioux City, etc. Ry. Co. v. Manhattan Trust Co.*, 92 Fed. 428; 34 C. C. A. 431.

⁴ *Farmers' L. & T. Co. v. San Diego Street-Car Co.*, 45 Fed. 518, 528 (headnote inadequate); *Western Supply, etc. Co. v. U. S., etc. Trust Co. (Tex.)*, 92 S. W. 986.

Contra: *Nelson v. Hubbard*, 96 Ala. 238; 11 So. 428; 17 L. R. A. 375. Cf. *Mowry v. Farmers' L. & T. Co.*, 76 Fed. 38, 45-46; 22 C. C. A. 52; *Andrews v. Nat. Foundry, etc. Works*, 76 Fed. 166, 176; 22 C. C. A. 110; 77 Fed. 774; 23 C. C. A. 454; 36 L. R. A. 139; *William Firth Co. v. South Carolina Loan, etc. Co.*, 122 Fed. 569; 59 C. C. A. 73.

⁵ *Atlantic Trust Co. v. Woodbridge Canal, etc. Co.*, 79 Fed. 842; *Illinois, etc. Bank v. Pacific Ry. Co.*, 117 Cal. 332; 49 Pac. 197; *William Firth Co. v. South Carolina Loan, etc. Co.*, 122 Fed. 569; 59 C. C. A. 73. Cf. *Waterloo Organ Co.*, 134 Fed. 345; 67 C. C. A. 327.

hold that bonds deliberately issued for less than par will not necessarily be invalidated thereby, provided the subscribers paid the actual market value of the securities.¹ A subscriber to bonds who pays full value therefor is not by any such statutory provision bound to see to the application of the proceeds of the issue by the company, nor will his bonds be invalidated because the company or its officers may divert the proceeds to improper purposes.² The validity of bonds issued in violation of such a statutory provision may be questioned by subsequent as well as prior creditors of the corporation.³

§ 1696. **Statutes expressly prohibiting Issue at a Discount or for less than a certain Rate.** — Even where bonds are issued at a discount in the teeth of an explicit statutory prohibition, they may be valid in the hands of a *bona fide* purchaser.⁴ Moreover, where bonds are issued as collateral security for a debt of the company in violation of a statute requiring 75 per cent of their value to be paid in prior to the issue, and for that reason are void, the company cannot maintain a bill in equity for their cancellation without first tendering payment of the debt for which they were pledged: ⁵ who seeks equity must do equity.

§ 1697. **Issue of Bonds together with Shares for less than aggregate face Value.** — Sometimes bonds or debentures and shares are issued together under one contract for a sum less than the aggregate par value of both. In such cases, if the discount, or any part thereof, is to be charged to the shares, the transaction is attended with the same consequences as any other issue of shares at a discount. On the other hand, if the whole of the discount represents a deduction from the price of the bonds or debentures, the transaction (usury laws and other prohibitory

¹ *Union, etc. Trust Co. v. Southern Cal., etc. Co.*, 51 Fed. 840, 845-846.

Cf. *Nelson v. Hubbard*, 96 Ala. 238, 250; 11 So. 428; 17 L. R. A. 375; *Northside Ry. Co. v. Worthington*, 88 Tex. 562; 30 S. W. 1055; 53 Am. St. Rep. 778.

² *Peoria, etc. R. R. Co. v. Thompson*, 103 Ill. 187.

³ *Wyoming Valley Ice Co.*, 153 Fed. 787, affirmed *sub nom. Wiegand v. Lewis Lumber Co.*, 158 Fed. 608.

⁴ *Mercer County v. Hackett*, 1 Wall

83 (a case of municipal bonds); *Union, etc. Trust Co. v. Southern Cal., etc. Co.*, 51 Fed. 840, 847-848 (headnote inadequate); *Ellsworth v. St. Louis, etc. R. R. Co.*, 98 N. Y. 553 (headnote inadequate); *Wyoming Valley Ice Co.*, 153 Fed. 787 (semble, as to bonds issued in violation of a statute such as those considered in the last paragraph), affirmed *sub nom. Wiegand v. Lewis Lumber Co.*, 158 Fed. 608.

⁵ *Hinckley v. Pfister*, 83 Wisc.

statutes apart) is quite unimpeachable. Thus, where a company agrees in consideration of £10 to issue a ten-pound debenture and give two five-pound shares as a bonus, if any part of the money paid, however small, is to be deemed to have been paid for the debentures, the shares were issued at a discount; and the subscriber may accordingly be held liable in a winding-up to pay in full the par value of the shares.¹ And even where the case is not so clear — for example, where in consideration of \$80,000, shares to the par value of \$50,000 and bonds to the amount of \$60,000 are issued — the court may conclude that the transaction is illegal as a mere evasion of the rule against issuing shares at a discount.²

§ 1698. **Issue at a Discount of Bonds convertible into Shares.** — To issue at a discount a bond which is convertible into shares of capital stock equal in nominal value to the par value of the bond is tantamount to an issue of shares at a discount in the first instance, and is therefore open to the same objections.³

§ 1699. **Issue as Collateral Security for a Debt.** — Since bonds or debentures may be issued at a discount, *a fortiori* they may be issued as collateral security for a debt of the company less than their face value; and the creditor to whom they are so issued may prove, even in competition with other bondholders or debenture-holders of the same series, for the full amount of

¹ *Railway Time Tables Co.*, 62 L. J. Ch. 935. Cf. *London & County Ass. Co.*, 30 L. J. Ch. 373; *Hebberd v. Southwestern Land Co.*, 55 N. J. Eq. 18; 36 Atl. 122; *Morrow v. Nashville Iron & Steel Co.*, 87 Tenn. 262; 10 S. W. 495; 10 Am. St. Rep. 658; 3 L. R. A. 37; *Kraft v. Griffon Co.*, 82 N. Y. App. Div. 29; 81 N. Y. Supp. 438 (where the court enjoined the issue of shares as a "bonus" to subscribers to bonds); *Dickerman v. Northern Trust Co.*, 176 U. S. 181, 202; 20 Sup. Ct. 311.

² *Gamble v. Queens County Water Co.*, 123 N. Y. 91, 108–109; 25 N. E. 201; 9 L. R. A. 527. Cf. *Toledo, etc. R. R. Co. v. Continental Trust*

Co., 95 Fed. 497, 511–521; 36 C. C. A. 155 (where a statute prohibited the issue of bonds for less than 75 per cent of the par value, but permitted an issue of shares for less than par); *Weed v. Gainesville R. R. Co.*, 119 Ga. 576; 46 S. E. 885; *Montgomery Iron Works v. Roman* (Ala.), 41 So. 811 (holder of the shares not entitled to claim that entire amount paid should be applied in payment of the shares so as to relieve him from liability as holder of unpaid shares).

³ *Sturges v. Stetson*, 1 Biss. 246; *Moseley v. Koffyfontein Mines* (1904), 2 Ch. 108 (issue of the convertible bonds enjoined).

the par value of the bonds or debentures, receiving dividends, however, only up to the amount of his debt.¹ Such hypothecation of bonds or debentures is governed in the main by the same rules as any other mortgage or pledge. For instance, an agreement, made at the time of the hypothecation, whereby an option is given to the creditor to purchase the hypothecated bonds is invalid, in accordance with the maxim "once a mortgage always a mortgage."² The pledgee may sell the bonds in the exercise of his power of sale,³ or, it has been held, if he chooses to waive that right, he may, after recovering judgment against the company, levy upon the bonds as its property.⁴ It has been held that where bonds recite that they are issued as collateral security for an indebtedness which is overdue, every holder is charged with constructive notice of all defences and is therefore subject to all infirmities attaching to the bonds,⁵ — a harsh conclusion, for which, it is submitted, no satisfactory reason can be assigned. The issue of bonds as collateral security for an indebtedness of the company gives the pledgee in respect to coupons which mature before the principal debt the same rights as any other coupon-holder⁶ in respect to filing bills for foreclosure and the

¹ *Regent's Canal Ironworks Co.*, 3 Ch. D. 43; *Georgetown Water Co. v. Fidelity Trust, etc. Co.*, 78 S. W. 113; 117 Ky. 325; *Western Supply, etc. Co. v. U. S., etc. Trust Co. (Tex.)*, 92 S. W. 986.

Cf. *Robinson v. Montgomeryshire Brewery Co.* (1896), 2 Ch. 841; *Duncomb v. New York, etc. R. R. Co.*, 84 N. Y. 190; s. c. 88 N. Y. 1; *Jesup v. City Bank*, 14 Wisc. 331; *Hunt & Bro. v. Memphis, etc. Co.*, 95 Tenn. 136; 31 S. W. 1006; *Richardson v. Green*, 133 U. S. 30; 10 Sup. Ct. 280; *Farmers' L. & T. Co. v. Toledo, etc. R. R. Co.*, 54 Fed. 759; *Whitehaven Joint Stock Banking Co. v. Reed*, 54 L. T. 360.

But see *Third Nat. Bank v. Eastern R. R. Co.*, 122 Mass. 240; *Simmons v. Taylor*, 23 Fed. 849, 857 (with which compare s. c. at a subsequent stage in the lower court, 38 Fed. 682, and on appeal, *sub nom. Simmons v. Burlington, etc. Ry. Co.*,

159 U. S. 278; 16 Sup. Ct. 1). See also *Wheelwright v. St. Louis, etc. Transportation Co.*, 56 Fed. 164, where the pledgee had sold the bonds for a small amount.

As to the effect of statutes prohibiting the issue of bonds except for money or property actually received, see *supra*, § 1695.

² *Samuel v. Jarrah Timber, etc. Corp.* (1904), A. C. 323.

³ *Union Cattle Co. v. International Trust Co.*, 149 Mass. 492; 21 N. E. 962. As to purchase of the pledged bonds by the pledgee, see *Farmers' L. & T. Co. v. Toledo, etc. R. R. Co.*, 54 Fed. 759; *Atlantic Trust Co. v. Woodbridge Canal, etc. Co.*, 86 Fed. 975.

⁴ *Sickles v. Richardson*, 23 Hun (N. Y.) 559. Cf. *infra*, § 1716.

⁵ *Higgins v. Lansingh*, 154 Ill. 301, 387-389; 40 N. E. 362.

⁶ *Vint & Sons* (1905), 1 Ir. 112.

like,¹ and therefore the same rights pass to a transferee even with full notice.² Bonds or debentures which are issued by the company as collateral security are issued for all purposes, and hence when redeemed by payment of the mortgage debt are extinguished and cannot subsequently be reissued.³

§ 1700. **Issue in Fraud of Creditors.** — An issue of bonds or debentures may of course in some circumstances be void as a fraudulent preference, or for similar reasons.⁴ But the mere fact of the company's insolvency at the time of an issue of mortgage bonds will not invalidate the issue where the proceeds are intended to enable the company to meet its current expenses.⁵

§ 1701. **Irregular Issue, when fatal — Application of Rule in Royal British Bank v. Turquand.** — The fact that bonds or debentures are issued irregularly — that is to say, without complying with the regulations as to the company's indoor management, — will not render them invalid if the persons to whom they were issued had no notice of the irregularity. In other words, the rule in *Royal British Bank v. Turquand*, which has already been considered at some length,⁶ applies to bonds or debentures as well as to other contracts of corporations.⁷ Furthermore, the fact that ordinary bonds or debentures are intended to be freely transferable and are, indeed, as will presently be more particularly explained, negotiable instruments, the doctrine of *Royal British Bank v. Turquand* as applied to them undergoes a certain extension, so as to sustain the validity of irregularly issued instruments which, although the original subscribers had notice of the irregularity, have since come into the hands of innocent purchasers. This is true although the irregularity would constitute a legal, and not merely an equitable, defence to the instrument in the hands of the original subscriber. Thus, debentures issued in pursuance of a resolution passed at a shareholders' meeting which was not attended by a quorum will be valid in the hands

¹ *Warner v. Rising Fawn Iron Co.*, 3 Woods 514. 42 N. J. Eq. 397; 8 Atl. 523. Cf. *Allen v. Montgomery R. R. Co.*, 11

² *Warner v. Rising Fawn Iron Co.*, 3 Woods 514 (headnote inadequate). Ala. 437, 451-453 (headnote misleading).

³ See *infra*, § 1820.

⁶ *Supra*, § 1472-§ 1476.

⁴ Cf. *Farmers' L. & T. Co. v. San Diego Street-Car Co.*, 45 Fed. 518. (1901), 2 K. B. 314. See also cases cited *supra*, § 1475, many of which related to issue of bonds.

⁵ *Bergen v. Porpoise Fishing Co.*,

of an innocent purchaser, although the original subscriber was present at the meeting and knew of the irregularity.¹

§ 1702-§ 1705. *Ultra Vires Issue.*

§ 1702. **In general.** — Where an issue of bonds or debentures is not merely irregular, but is *ultra vires* of the corporation, the question whether or not the securities are binding upon the company depends upon the view that is adopted towards *ultra vires* contracts in general.² No distinction in this respect is possible between bonds or debentures and other contracts.

§ 1703. **Effect of Negotiability on Application of Doctrine of Ultra Vires.** — To be sure, the negotiability of bonds and debentures may have some bearing upon the applicability of the doctrine of *ultra vires*. It seems clear that where an issue of bonds or debentures is wholly *ultra vires*, the defence is as available against a *bona fide* purchaser as against the original holder.³ On the other hand, where the issue would be *intra vires* if certain facts exist which lie peculiarly within the company's own knowledge, any one who deals with the corporation may, according to the prevalent doctrine, rely upon the company's representation that those facts do exist, and the contract will be enforceable whatever the truth of the case may be.⁴ For instance, to issue bonds for the purpose of engaging in some business foreign to the objects for which the company was created is *ultra vires*, but since this is true because of a fact — the company's intention — lying peculiarly within the knowledge of the corporation, bonds so issued are binding unless the subscriber was aware of the unlawful intent,⁵ and even if the original subscriber be affected with

¹ *Romford Canal Co.*, 24 Ch. D. 85. For other illustrations of the same principle, see *Louisville, etc. Ry. Co. v. Louisville Trust Co.*, 174 U. S. 552; 19 Sup. Ct. 817; and *supra*, § 1475.

² As to this, see *supra*, Chapter XVI.

³ *Smead v. Indianapolis, etc. R. R. Co.*, 11 Ind. 104; *Scott v. Bankers' Union* (Kans.), 85 Pac. 604.

⁴ Cf. *Stoney v. American Life Ins. Co.*, 11 Paige Ch. (N. Y.) 635; *Madi-*

son, etc. R. R. Co. v. Norwich Sav. Soc., 24 Ind. 457. See also *infra*, § 1705.

⁵ *David Payne & Co.* (1904), 2 Ch. 608. *A fortiori*, the misapplication of the company's officers of borrowed money is no defence to an action by the creditor who was not implicated in the wrong. *Thompson v. Lambert*, 44 Iowa 239; *Buffalo Loan Co. v. Medina Gas Co.*, 12 N. Y. App. Div. 199; 42 N. Y. Supp. 781; *Robinson v. Dolores, etc.*

notice, the instruments will be enforceable in the hands of a *bona fide* purchaser. In such a case, although the defence of *ultra vires* might have been successfully interposed against the original subscriber, it is not maintainable against a *bona fide* purchaser. So, it has been held that a bond issued without consideration may be enforced by a purchaser for value without notice.¹

§ 1704. **Application of Proceeds to Ultra Vires Purpose.** — Of course, the validity of bonds or debentures is not affected by the application of the proceeds to unauthorized *ultra vires* or illegal purposes, and that too even in a case where the company has power to issue bonds only for a certain specified purpose.² Indeed, the misapplication of borrowed money is never a defence to the debtor.³ Moreover, as pointed out in the preceding section, the fact that the bonds were issued for a wrongful or *ultra vires* purpose would not affect their validity unless the holder were privy to the intent.⁴

§ 1705. **Effect of Limitations on Amount which Company may borrow.** — Limitations on the amount which a corporation may borrow are sometimes found.⁵ In England, any borrowing on bonds, debentures, or otherwise in excess of that limit is wholly void. Probably this would be nowhere held in the United States.⁶ And even according to the principles which are ac-

Canal Co., 2 Colo. App. 17; 29 Pac. 750.

Cf. *Carpenter v. Black Hawk Gold Mining Co.*, 65 N. Y. 43.

¹ *Tod v. Kentucky Union Land Co.*, 57 Fed. 47; 6 C. C. A. 685.

² *Camden Safe Deposit, etc. Co. v. Citizens Ice, etc. Co.* (N. J. Ch.), 61 Atl. 529.

³ See cases cited *supra*, p. 1407, n. 5.

⁴ See also *supra*, § 1061.

⁵ Cf. *supra*, § 118.

⁶ *Fidelity, etc. Co. v. West Pa., etc. R. R. Co.*, 138 Pa. St. 494; 21 Atl. 21; 21 Am. St. Rep. 911; *Hackensack Water Co. v. De Kay*, 36 N. J. Eq. 548; *Reed's Appeal*, 122 Pa. St. 565; 16 Atl. 100; *Baker v. Guarantee Trust, etc. Co.*, 31 Atl. Rep. 174 (N. J.); *Peatman v. Centreville Light, etc. Co.*, 100 Iowa

245; 69 N. W. 541; *Sioux City Terminal, etc. Co. v. Trust Co. of North America*, 82 Fed. 124; 27 C. C. A. 73; *Vanderveer v. Asbury Park, etc. Ry. Co.*, 82 Fed. 355 (holding that bonds issued in excess of the limit are void unless they have come to the hands of *bona fide* purchasers); *Wood v. Corry Waterworks Co.*, 44 Fed. 146; 12 L. R. A. 168; *Ossipee, etc. Mfg. Co. v. Canney*, 54 N. H. 295, 322 (statute held to be directory merely); *Weber v. Spokane Nat. Bank*, 64 Fed. 208; 12 C. C. A. 93 (statute construed, substantially, as directory).

But see *Commonwealth v. Smith*, 10 Allen (Mass.) 448; 87 Am. Dec. 672; *Bell, etc. Co. v. Kentucky Glass-Works Co.* (Ky.), 50 S. W. 2 (holding that a creditor who has notice of the fact that the limit has

cepted in England, it is difficult to see why the excessive borrowing could not be sustained for the benefit of innocent persons dealing with the corporation or purchasing the bonds, upon the ground that whether or not the limit of the borrowing power has been reached lies peculiarly within the company's own knowledge.¹ A contract to issue debentures as soon as the company's power to borrow money should arise has been pronounced valid.²

§ 1706. **Issue of Bonds with some unauthorized or illegal Features.** — That one clause of a corporate bond is in conflict with a statute and therefore void will not necessarily vitiate the rest of the instrument.³ Of course, the fact that the covering deed of trust may be void as unauthorized does not invalidate the bonds as obligations of the company.⁴

§ 1707. **Construction of Statutes regulating "Increase" of bonded Debt.** — A statute providing that the bonded indebtedness of a corporation shall not be "*increased*" without the consent of the persons holding the larger amount in value of the company's stock at a meeting called for that purpose, sixty days' notice being given, has been declared to have no application to the first creation of bonded indebtedness.⁵

been reached, while he may have a right against the company, cannot compete with other creditors who had no notice of the excess of power).

¹ Cf. *Ossipee, etc. Mfg. Co. v. Canney*, 54 N. H. 295, 326; *Gordon v. Sea Fire Life Ass. Soc.*, 1 H. & N. 599; *Bell & Coggeshall Co. v. Ky. Glass-Works Co. (Ky.)*, 50 S. W. 2; 20 Ky. Law Rep. 1684 (holding that record of a prior mortgage is not constructive notice of the fact that the limit of indebtedness has been reached); *First Nat. Bank v. D. Kieffer Milling Co.*, 95 Ky. 97; 23 S. W. 675 (holding that creditor whose own claim exceeds the limit cannot as to the excess compete with other creditors); *Connecticut River Sav. Bank v. Fiske*, 60 N. H.

363, 369; *Auerbach v. Le Sueur Mill Co.*, 28 Minn. 291; 9 N. W. 799; 41 Am. Rep. 285; *Cann v. International Trust Co.*, 40 Nova Scotia 65 (headnote inadequate).

² *Bagnalstown & Wexford Ry. Co.*, Ir. Rep. 4 Eq. 505.

But see *West Cornwall Ry. Co. v. Mowatt*, 17 L. J. Ch. n. s. 366.

³ *Howell v. Western R. R. Co.*, 94 U. S. 463 (headnote inadequate). Cf. *Wood v. Whelen*, 93 Ill. 153; *Jesup v. City Bank*, 14 Wisc. 331. See also *infra*, § 1885.

⁴ *Philadelphia, etc. R. R. Co. v. Lewis*, 33 Pa. St. 33; 75 Am. Dec. 574; *Illinois, etc. Bank v. Pacific Ry. Co.*, 117 Cal. 332, 343; 49 Pac. 197.

⁵ *Union, etc. Trust Co. v. Southern River Sav. Bank*, 51 Fed. 840, 850.

§ 1708. **Incomplete Bonds or Debentures — Instruments containing Blanks.** — Bonds or debentures are sometimes issued in an incomplete state, particularly with blanks not filled up. When the blank is for the name of the payee, then, as will be explained below, the instrument, according to the weight of authority, is virtually payable to bearer and any holder may fill up the blank with his own name.¹ In an English case, however, it was thought that the issue of debentures containing blanks amounted merely to a contract to issue complete debentures.² At any rate, it is not every blank in a corporation bond that any holder or transferee will have implied authority to fill up. For instance, where bonds declared that the president of the company was authorized by his endorsement to designate the place of payment, and the bonds bore an indorsement in the following form, "I hereby agree that the within bond and the interest coupons thereto attached shall be payable in ———," the court held that the holder had no implied authority to fill out the blank.³

§ 1709. **Delivery as a necessary Part of Issue.** — Delivery is in general essential to the enforceability of bonds and debentures.⁴ Hence, if debentures which have been sealed but not delivered are fraudulently abstracted and put upon the market, they are void.⁵ This is true in spite of the old doctrine that a deed of a corporation requires no delivery.⁶ For even if that doctrine were to be followed at the present day, it would be shorn of all practical consequences by the modern qualification that the deed cannot be sued upon until actual delivery or something tantamount thereto.⁷ The company may be estopped to deny delivery. Thus, where bonds signed, sealed, and countersigned in due form are intrusted to the company's president, by whom they are wrongfully negotiated, the instruments will be valid in the hands of a *bona fide* purchaser.⁸

¹ *Infra*, § 1747.

² *Perth Electric Tramways* (1906), 2 Ch. 216.

³ *Jackson v. Vicksburg, etc. R. R. Co.*, 2 Woods 141; *Ledwich v. McKim*, 53 N. Y. 307.

⁴ *Cf. Webster v. Whitworth* (Tenn.), 63 S. W. 290.

⁵ *Mowatt v. Castle Steel, etc. Co.*, 34 Ch. D. 58.

Cf. Parsons v. Jackson, 99 U. S.

434.

⁶ See *supra*, § 484.

⁷ *Gartside v. Silkstone, etc. Co.*, 21 Ch. D. 762, 768.

⁸ *Pittsburgh, etc. Ry. Co. v. Lynde*, 55 Oh. St. 23; 44 N. E. 596.

§ 1710-§ 1714. *Authentication by Trustee's Certificate.*

§ 1710. **Want of Certificate — Whether fatal to Enforceability of Bond.** — American bonds usually contain a provision that they shall not become obligatory until authenticated by the signature of the trustee, or where the trustee is a corporation, of some officer thereof. A very strong case of estoppel would have to be made out in order to hold the company on bonds issued without such authentication. At all events, where bonds are signed by the proper officers of the company, but before the seal is affixed are stolen and a counterfeit seal and a forged certificate attached, the mere fact that the company neglects to warn the public of the theft is obviously insufficient to overcome the want of authentication by the genuine certificate of the trustee so as to estop the company from denying liability upon the bonds to a purchaser for value without notice of the forgery.¹ On the other hand, the failure or refusal of the trustee to perform a positive duty to certify bonds will not affect the rights of holders.²

§ 1711. **Certificate of Trustee as Proof of Regularity of Issue.** — Conversely, if the trustee has authenticated the bonds by his certificate, the company will be liable upon them to a *bona fide* holder for value although they were issued by an officer of the company for his own benefit.³ The trustee's certificate is, as against the company and in favor of a *bona fide* purchaser, almost conclusive evidence of the regularity of the issue.

§ 1712. **Trustee's Certificate as Warranty of Facts stated therein.** — The trustee's certificate amounts to a warranty by the trustee to the holder of the bond that the facts stated in the certificate are true. Thus, where the certificate stated that the bond was one of a series secured by a deed of trust, and no such deed was ever recorded, the trustee must make good the loss to the bondholder.⁴ The statute of limitations does not begin to run against an action upon such a warranty until the bond becomes due.⁵

¹ *Maas v. Missouri, etc. Ry. Co.*, 83 N. Y. 223.

² *Atwood v. Shenandoah Valley R. R. Co.*, 85 Va. 966, 991-992.

³ *Long Island, etc. Trust Co. v. Columbus, etc. Ry. Co.*, 65 Fed. 455;

Doty v. Oriental Print Works (R. I.), 67 Atl. 586.

⁴ *Miles v. Roberts*, 76 Fed. 919.

As to a warranty that debentures are within a legal limit upon the amount of indebtedness, see *White-*

haven Joint Stock Banking Co. v. Reed, 54 L. T. 360.

⁵ *Miles v. Roberts*, 76 Fed. 919.

On the other hand, although the bonds purport to be "first mortgage bonds," the trustee by signing the certificate does not warrant that there is no prior lien on the property covered by the mortgage,¹ and most certainly does not warrant that the property covered by the charge is an adequate security.²

§ 1713. **Other Liabilities of Trustee for Executing Certificate.** — If it be provided that the trustee shall not authenticate any bonds without first receiving from the company sufficient funds to pay the first four coupons, an issue of bonds by the trustee without observing that requirement will not be ground for a suit in equity by a person for whom the trustee at the company's direction has agreed to hold certain bonds; the remedy, if any, is at law.³ But in a proper form of proceeding, if the trustee certifies bonds without insisting on performance of conditions precedent required by the deed of trust, he is bound to make good the loss to any holder of such bonds.⁴

§ 1714. **Right of Company to require Trustee to authenticate Bonds by Certificate.** — The authentication by the trustee frequently involves the exercise of more or less discretion; but as a general rule the company has the right to command the trustee to authenticate any bonds to be issued for a legitimate purpose. Restrictions upon this right of the company will not be extended by construction.⁵ And a court of equity will compel the trustee to attach his certificate to bonds which the company has the right to issue.⁶

§ 1715. **Ratification of Bonds issued without Authority.** — An unauthorized issue of bonds may of course be ratified. Indeed, even though bonds may recite that each is to be "issued only by the previous specific vote" of the directors at a duly

¹ *Tschetinian v. City Trust Co.*, Atl. 33. But see *Polhemus v. Holland Trust Co.*, 61 N. J. Eq. 654.
89 N. Y. Supp. 1053; 97 N. Y. App. Div. 380; affirmed 186 N. Y. 432; 79 N. E. 401.

² *Bauernschmidt v. Maryland Trust Co.*, 89 Md. 507; 43 Atl. 790.

³ Cf. *Denver, etc. R. Co. v. U. S. Trust Co.*, 41 Fed. 720.

⁴ *Denver, etc. R. Co. v. U. S.*

⁵ *Spring v. Commonwealth Title Trust Co.*, 41 Fed. 720.
Ins., etc. Co., 206 Pa. St. 548; 56

convened meeting, bonds issued without such previous vote will nevertheless be valid if ratified by the directors.¹

§ 1716. **Unissued Bonds or Debentures — Nature, etc.** — Unissued bonds are mere pieces of paper, and must not be so dealt with as if they had any value in themselves.² Thus, unissued bonds in the hands of an agent of the company are not liable to attachment upon a judgment against the company;³ and hence where unissued bonds are seized and sold under an execution against the company, the purchaser gets no title.⁴ Perhaps, in such a case, a court of equity at the instance of the judgment creditor would enjoin the company from issuing the bonds, and thus prevent the company from diminishing the value of its attachable interest in the property subject to the mortgage, by an increase in the number of the outstanding bonds.⁵

§ 1717-§ 1718. *Reissue of Bonds or Debentures.*

§ 1717. **Reissue of lost Bonds or Debentures.** — If a bond or debenture which has been duly issued is lost or destroyed, a court of equity has jurisdiction to relieve against the accident. Upon giving an adequate bond of indemnity the owner may not merely compel the company to pay to him the interest and principal as they become due and payable, but he may also require the company to issue to him a new bond in the place of that lost or destroyed.⁶ This relief is necessary in order to put the true owner back in substantially the same position as he was in before the accidental loss or destruction. On the other hand, especially in the case of bond having a long term to run before maturity,

¹ *Mason v. York, etc. R. R. Co., etc. Co. v. Gallego Mills Co.*, 101 Va. 52 Me. 82, 112-114. 579, 584; 44 S. E. 760 (unissued

² Cf. *infra*, § 1848, § 1886, and bonds held not to be subject to a

§ 1896. statutory lien for supplies furnished the company).

³ *Coddington v. Gilbert*, 17 N. Y. 489; *Means v. Cincinnati, etc. R. R.* ⁴ *Sickles v. Richardson*, 23 Hun (N. Y.) 559. Cf. *supra*, § 1699.

Cable Co. v. Great Western Mfg. Co., 164 Mass. 274; 41 N. E. 295; *Richardson v. Green*, 133 U. S. 30, 47 (headnote inadequate); 10 Sup. Ct. 280; *Alabama Marble, etc. Co. v. Chattanooga Marble, etc. Co.* (Tenn.), 37 S. W. 1004, 1013. ⁵ As to the relative rights of a creditor levying upon the mortgaged property and a holder of bonds subsequently issued and secured by the same mortgage, see *infra*, § 1848 and notes.

⁶ *Chesapeake & Ohio Canal Co. v. Barnes v. Mobile, etc. R. R. v. Blair*, 45 Md. 102. Co., 12 Hun (N. Y.) 126; *Millhiser*,

there is certainly a difficulty in giving adequate indemnity. In the Maryland case above cited,¹ the owner of the lost bond was willing to accept a non-negotiable instrument in its place, thus obviating much of this difficulty.

§ 1718. **Reissue of paid or redeemed Bonds or Debentures.** — Bonds or debentures which have been paid, redeemed or surrendered, cannot, in general, be reissued so as to rank as bonds of the same series as those which they replace.² But an exchange of engraved for lithographed bonds is not deemed a reissue of cancelled bonds but has the same effect as the replacement of a lost bond.³

§ 1719-§ 1728. **CONTRACTS TO ISSUE BONDS OR DEBENTURES — SUBSCRIPTIONS TO BONDS.**

§ 1719. **Nature of Contract of Subscription.** — Although, as already stated, the legal nature of a bond or debenture is that of an ordinary contract with the corporation, yet inasmuch as bonds and debentures are now a recognized form of corporate security, agreements to subscribe to a company's bonds take a form not dissimilar to subscriptions to shares. In law, however, an ordinary subscription to corporate bonds or debentures is a contract to lend money to the company. It certainly cannot be regarded as a contract to purchase bonds as property of the company.⁴ Nor is the contract except under special circumstances subject to the special rules applicable to contracts between parties one of whom stands in a fiduciary relation to the other.⁵

§ 1720-§ 1721. *Rights of Company against the Subscriber.*

§ 1720. **In general.** — Since a contract to lend money will not be specifically enforced against the lender, it has been held that a contract to take from the company a number of its bonds, and to pay for them, will not be specifically enforced against the subscriber.⁶ And if the subscriber fail to pay the instalments as they fall due, the company cannot recover the

¹ *Chesapeake & Ohio Canal Co. v. Blair*, 45 Md. 102.

² See *infra*, § 1820, § 1896.

³ *Illinois, etc. Bank v. Pacific Ry. Co.*, 117 Cal. 332; 49 Pac. 197.

⁴ *South African Tys. v. Wallington* (1898), A. C. 309. Cf. § 1692.

⁵ *Atwood v. Shenandoah Valley R. R. Co.*, 85 Va. 966.

⁶ *South African Tys. v. Wallington* (1898), A. C. 309.

overdue instalments as a debt, but is remitted to an action for its damages, which can rarely be proved to be more than nominal.¹ This decision, however, was very inconvenient, and Parliament has now interposed and provided that in such cases specific performance may be decreed.² It would seem that a chancellor animated by a broad spirit of equity might have granted specific performance without any legislative direction.

§ 1721. **Effect of Liquidation or hopeless Insolvency of the Company.** — A subscriber to bonds or debentures is, as a rule, released from any obligation to pay for them, if before such payment the company goes into liquidation or becomes hopelessly insolvent. For the company becomes thereby disabled from carrying out its part of the contract. Thus, where a company issued scrip which declared that the holders on making certain payments to the company would become entitled to the issue of debentures, and provided that if any payment should not be promptly made any instalments previously paid should be liable to forfeiture without further notice, the court held that after the company went into liquidation the scripholders might decline to pay further instalments without risk of forfeiting those already paid.³ Even if the bonds or debentures had been actually issued but not fully paid for, the same principle would seem to apply; but, as bonds and debentures, being negotiable instruments, are not usually issued until fully paid for, that question is not likely to arise.

§ 1722-§ 1724. *Rights of Subscriber against the Company — Subscriber as Holder of Bonds in Equity.*

§ 1722. **In general.** — Inasmuch as an agreement to give security for a debt will be specifically enforced in equity in favor of the creditor unless the debtor will pay the debt,⁴ it follows

¹ *South African Tys. v. Wallington* (1898), A. C. 309. Cf. *Bahamas, etc. Plantation v. Griffin*, 14 Times L. R. 139 (as to the measure of damages).

As to actions by a corporation against one who has subscribed to its bonds, see further, *Galena, etc. R. R. Co. v. Barrett*, 95 Ill. 467; *New Jersey Midland Ry. Co. v. Strait*, 35 N. J. Law 322; *Davis*

Bros. v. Montgomery Furnace, etc. Co., 101 Ala. 127; 8 So. 496 (claim of company against subscriber attached by a creditor).

² Companies Act, 1907 (7 Edw. VII, c. 50), § 16.

³ *Consolidated Land Co.*, 20 W. R. 855.

Cf. *supra*, § 440.

⁴ *Hermann v. Hodges*, 16 Eq. 18.

that if a subscriber to bonds or debentures has paid for them, the company will be compelled by a court of equity to issue the instruments secured by a mortgage or charge as agreed; or upon the principle that equity will treat that as done which ought to be done, the subscriber will be treated in equity as a holder of the bonds or debentures which were agreed to be issued to him.¹ Thus, a holder of scrip entitling him to have debentures issued to him will be deemed in equity a holder of debentures.² So, a person who has an option to take debentures in exchange for some other security will be entitled in equity to all the rights of a debenture-holder, in respect to interest and otherwise, from the time of exercising his option.³ Similarly, a person to whom the company has contracted to issue debentures in payment for goods sold has priority over a judgment creditor of the company who is seizing its goods under a *fi. fa.*⁴

¹ *Strand Music Hall Co.*, 3 De G. J. & S. 147; *Stevenson's Case*, 2 Megone 360, 364-365; *Texas Western Ry. Co. v. Gentry*, 69 Tex. 625; 8 S. W. 98.

Cf. *White Water Valley Canal Co. v. Vallette*, 21 How. 414; *Fidelity Ins., etc. Co. v. Shenandoah Valley R. R. Co.*, 33 W. Va. 761; *Atwood v. Shenandoah Valley R. R. Co.*, 85 Va. 966, 991-992; *Blair v. St. Louis, etc. R. Co.*, 23 Fed. 524; *Spence v. Mobile, etc. Ry. Co.*, 79 Ala. 576; *Rice's Appeal*, 79 Pa. St. 168.

As to the effect of an agreement to issue bonds when authorized by the state railway commission, see *Augusta Trust Co. v. Federal Trust Co.*, 140 Fed. 930, affirmed, 153 Fed. 157.

As to an action at law by a person entitled to bonds against a company which wrongfully refuses to issue them, compare *Chaffee v. Rutland R. R. Co.*, 55 Vt. 110.

² *Thorn v. Nine Reefs*, 67 L. T. 93; *Jenkins v. John Good Cordage, etc. Co.*, 56 N. Y. App. Div. 573; 68 N. Y. Supp. 239 (semble).

Cf. *Girard Trust Co. v. Summit Branch Coal Co.*, 22 Pa. Super. Ct. 495 (where the scrip-holder, having made no claim until the mortgaged

property had been sold at a foreclosure sale, was held to be barred by laches from participating in the proceeds of sale); *Rommel v. Summit Branch Coal Co.*, 18 Pa. Super. Ct. 482 (similar to preceding case); *Attorney-General v. Mayor, etc. of Liverpool* (1902), 1 K. B. 411 (date of issue of scrip held to be date of "issue of loan capital" within the meaning of a tax law although some instalments of subscription remained unpaid).

³ *Pegge v. Neath, etc. Tramways* (1898), 1 Ch. 183.

Cf. *Wabash, etc. Ry. Co. v. Ham*, 114 U. S. 587, 597-598; 5 Sup. Ct. 1081 (where the right to exercise the option had been lost by laches); *Wakefield Water Co. v. New England Trust Co.*, 56 N. E. 703; 175 Mass. 478 (where the company after delivering a series of bonds to a trust company to be exchanged for bonds of a prior issue was held to have no power to prevent the exchange after holders of the earlier issue of bonds had deposited them with the trust company for exchange).

⁴ *Simultaneous Colour Printing Syndicate v. Fowerbaker* (1901), 1 K. B. 771.

This principle is carried so far that a person to whom the company is under contract to issue debentures of a certain series may in equity participate in the proceeds of the security *pari passu* with actual holders of debentures of that series although such participation diminishes the dividends payable to the actual debenture-holders: ¹ the argument will not prevail that the equity to have debentures issued is against the company and not against the existing debenture-holders.²

§ 1723. **Rights of Subscriber where entire Series of Bonds has been issued to other Persons.** — On the other hand, the United States Supreme Court has held that a contract by a corporation to issue bonds of a certain series secured in the usual way by a deed of trust will not entitle the other party to the contract to the benefit of that security where the whole series of the bonds has been issued and is outstanding, although some of the bondholders be for some reason precluded from proving for the full amount of their bonds.³ This case does not conflict with the principles stated in the last paragraph, because the determining factor was the circumstance that all the bonds of the series had been issued to other parties whose rights being founded on the deed of trust — a recorded paper — necessarily took precedence over the unrecorded contract. The ruling that some of the bondholders could not prove for the face value of their bonds, whether rightful or not, could not, the court held, enure to the benefit of the person with whom the company had made the contract, so as to give him the same rights as if the company had not issued the full quota of bonds. This last proposition is the only point decided in the case with which one might be disposed to quarrel.

§ 1724. **Reissue of paid or cancelled Bonds not a Contract to issue valid Bonds of the same Series.** — Moreover, a person who buys from the company certain bonds or debentures which had been previously transferred to the company itself and consequently merged and extinguished cannot participate ratably with the holders of other bonds or debentures of the same series, even though he may have made the purchase with the full expectation and belief that he would acquire the same rights as holders

¹ *Queensland Land & Coal Co.* (1894), 3 Ch. 181.

² Cf. *infra*, § 1886. But see *infra*, § 1723.

³ *Vose v. Bronson*, 6 Wall. 452.

of the other bonds or debentures:¹ it is not a case of a contract to give a particular security but of a contract to transfer particular instruments which in point of law have been extinguished and are therefore valueless. Indeed, even where a person takes bonds or debentures without knowledge of any prior dealing with them on the part of the company, nevertheless, if in point of fact the instruments so taken had been previously issued and redeemed, he is not entitled to rank as a holder of bonds or debentures in competition with holders of other instruments of the same series.²

§ 1725. **Right of Subscriber against a Person to whom his Bonds are Issued.** — If the company agrees to issue certain bonds to a subscriber who pays for them in full, it has been thought that the bonds in question are affected with a trust, so to speak, in favor of the subscriber, so that a person subsequently taking the bonds, by way of pledge or otherwise, with notice of the subscriber's rights, must account to the latter for the bonds so taken.³

§ 1726—§ 1728. *Construction of Contract of Subscription.*

§ 1726. **In general.** — Frequently, in the United States, the mortgage deed of trust is executed before any of the bonds are subscribed for, so that no question is apt to arise as to the nature of the security which the company has agreed to give. In some cases, however, a point of that kind may be brought up, and in other cases some different question may be made as to the terms of the subscription. Usually subscriptions to bonds or debentures, like subscriptions to shares, are made on the faith of a prospectus which virtually constitutes an offer on the company's part. In such cases the language of the prospectus must be looked at in order to determine the terms of the subscription.

§ 1727. **Required Certainty in regard to the promised Security.** — This subject is elucidated by an instructive pair of English cases relating to the same corporation. In the first case, S

¹ *George Routledge & Sons* (1904), 2 Ch. 474, 480. ² *Perth Electric Tramways* (1906), 2 Ch. 216.

Cf. *W. Tasker & Sons* (1905), 2 Ch. 587. ³ *Hubbard v. Manhattan Trust Co.*, 87 Fed. 51; 30 C. C. A. 520.

applied for an allotment of debentures "upon the terms of the company's prospectus," which stated among other things that the debentures would be a charge on "the entire property of the company." In reply, a letter of allotment was sent to S; but no debentures were ever issued, and no effective covering deed of trust was ever executed. The court held that S had a binding contract for the issue of debentures charged upon all the company's property, and was accordingly entitled in equity to a priority over the general creditors, to the same extent as if the debentures had been formally issued.¹ In the second case, the facts were similar except that the prospectus upon which the application was based, while it described the debentures as "First Mortgage Debentures," omitted to state that they would be secured by a charge upon all the company's property; and the court was therefore obliged to hold that there was nothing to show what property the lien of the debentures was to cover, so that in the absence of any contract for a definite security the subscriber could have only the rights of a general creditor.²

§ 1728. **Construction of Condition that a certain Number of Bonds must be subscribed.** — A stipulation in a subscription to bonds that the subscriber shall not be bound unless a certain number of bonds are disposed of has been held to mean that the required number must be taken at the same rate which this subscriber is to pay.³ Otherwise, the provision would be almost nugatory, since the company might issue the bonds for a merely nominal consideration.

§ 1729. **Construction of Bonds or Debentures when Issued.** — After debentures or bonds have been actually issued, a resort to the prospectus and other preliminary negotiations is rarely permissible for the purpose of determining the rights of the holders,⁴ unless, indeed, rescission of the contract is sought on the ground of fraudulent misrepresentation. The rights of the

¹ *Stevenson's Case*, 2 Megone 360, 364-365.

⁴ *Chicago, etc. Granaries Co.* (1898), 1 Ch. 263. Cf. *Banque*

² *Quin's Case*, 2 Megone 360, 365-366.

Franco-Egyptienne v. Brown, 34 Fed. 162.

³ *Dalrymple v. Lanman*, 23 Md. 376. Cf. *infra*, § 1890.

bondholders or debenture-holders must depend on the language of the bonds or debentures themselves and of any other papers, particularly the mortgage or deed of trust, therein referred to.

The bonds or debentures and the deed of trust should be construed as one instrument so as if possible to harmonize with one another.¹ In any case of clear discrepancy between them the terms of the bonds must prevail;² for the bonds are the substance, while the security is only the shadow.

Perhaps, in a case of doubt, the courts will incline towards the construction most favorable to the bondholder.³

§ 1730-§ 1763. *TRANSFER OF BONDS AND DEBENTURES.*

§ 1730. **Intention — How far to be effectuated.** — Corporate bonds or debentures are invariably intended to be freely transferable, and indeed to pass from hand to hand as negotiable instruments. Except in very rare cases, there is no question as to the intent, but the only question is whether the law will effectuate that intent.

§ 1731-§ 1732. *How far Incidents of Negotiability may be attached by Estoppel to Instruments not technically negotiable.*

§ 1731. **In general.** — Even if an instrument is for some technical reason held to be non-negotiable, it may through an application of the principle of estoppel acquire some of the attributes of negotiability. For instance, if a non-negotiable debenture is issued under such circumstances as to lead the public to believe that the company intended it to be transferable free of equities, the company will be estopped from setting up against a transferee any defences that would not have been available if the instrument had been truly negotiable.⁴ In order successfully

¹ Cf. *American Nat. Bank v. neapolis, etc. Ry. Co.*, 48 Minn. 560; *American Wood Paper Co.*, 19 R. I. 51 N. W. 658; 31 Am. St. Rep. 694. 149; 32 Atl. 305; 61 Am. St. Rep. ³ *Chicago, etc. R. R. Co. v. Pyne*, 746; 29 L. R. A. 103; *Benjamin v.* 30 Fed. 86, 90 (semble). *Elmira, etc. R. R. Co.*, 49 Barb. ⁴ *Blakely Ordnance Co.*, 3 Ch. (N. Y.) 441; *Low v. Blackford*, 87 154; *Imperial Land Co. of Mar-* seilles, 11 Eq. 478; *Ex parte Chorley*, Fed. 392; 31 C. C. A. 15. 11 Eq. 157; *Dickson v. Swansea-*

² *Railway Company v. Sprague*, 103 U. S. 756. Cf. *Guilford v. Min-* Vale Co., L. R. 4 Q. B. 44.

to invoke this doctrine, it must of course appear that the company intended that the instrument should be negotiable; and the most satisfactory proof of such intent would be the use of words of negotiability, such as "order" or "bearer." Less clear evidence will, however, suffice.¹ The same result would no doubt be reached although the bond or debenture was not originally intended to be transferable if the company, by registering the transfer or otherwise, should represent the legal title to the obligation to be assignable.² Indeed, this doctrine of estoppel to deny the negotiability of bonds or debentures has been applied rather liberally by the courts. For example, when the description of the bonds as contained in the mortgage indicates them to be negotiable, then, although the bonds themselves contain a stipulation (omitted from this description) which would ordinarily destroy their negotiability, the company and the bondholders will be estopped from asserting the instruments to be non-negotiable to the prejudice of innocent third persons who have changed their position, and incurred expense by instituting legal proceedings framed upon the theory that the bonds were negotiable as represented in the mortgage deed of trust.³

A fortiori, if the company permits judgment for either principal or interest of the bonds to be entered against it in favor of an assignee, it cannot subsequently dispute that the latter is the legal holder of a valid obligation.⁴

§ 1732. **Limits of this Doctrine of Estoppel.** — There are, however, some legal incidents of negotiability which this principle of estoppel cannot impart to bonds or debentures. For instance, upon no such principle can a transferee become entitled to maintain an action at law against the company in his own name, if objection to the proceeding be interposed before judgment.⁵ Nor can such an assignment cut off rights of third parties, as would be done if the instrument were truly negoti-

¹ *Higgs v. Northern Assam Tea Point R. R. Co.*, 24 Wisc. 93, 128-Co., L. R. 4 Ex. 387; *Northern Assam Tea Co.*, 10 Eq. 458.

But see *Natal Investment Co.*, 3 Ch. 355.

² *Brunten's Case*, 19 Eq. 302, ⁵ *Blakely Ordnance Co.*, 3 Ch. 154 overruling *Atheneum Life Ass. Co. v. Pooley*, 3 De G. & J. 294. (semble).

³ *Board of Supervisors v. Mineral Co.*, 55 Vt. 110, 139-140. But see *Chaffee v. Rutland R. R.*

able, so as to give a good title, for example, to a *bona fide* purchaser from a thief.

§ 1733-§ 1740. *Whether Bonds and Debentures are truly Negotiable.*

§ 1733. **Objections to Negotiability of Bonds and Debentures.** — In England, the legal obstacles in the way of holding corporate bonds or debentures to be negotiable have been thought very serious, and, until recently, insurmountable. This is abundantly shown by the cases cited in connection with the last two sections.

The first objection is that bonds and debentures are under the corporate seal and that the presence of the seal destroys the negotiability of an instrument that would otherwise be a promissory note. An answer to this objection is that the affixing of its seal is merely a corporation's way of signing its name, and that the so-called seal is not intended as a seal at all, but as a mere voucher of genuineness.¹ But that very purpose was the original, historic object of every seal; and, moreover, the supposed seal is undoubtedly intended as a true seal in most cases of corporate bonds or debentures. Where, instead of an actual impression or wax seal, a mere printed representation of the common seal is annexed, there is more reason for holding that the paper was not intended to be a sealed instrument.

Another objection to holding bonds and debentures to be negotiable promissory notes is that in the obligatory part the word "bind" is used instead of "promise"; but this objection has been very properly overruled since the word "bind" imports a promise.²

A final objection is that the conditions attached to the time or manner of payment destroy that entire certainty which is one of the indispensable requisites of a promissory note according to the ancient law merchant and the Statute of Anne.

§ 1734. **Mercantile Usage as Answer to Objections** — *English Authorities.* — An answer to all these objections is that the mercantile law is not fixed and stereotyped, but that a new custom of merchants is capable of enlarging the category of negotiable

¹ *Imperial Land Co. of Marseilles*, 11 Eq. 478, 484, 492, where it was conceded by counsel for defendant. Cf. *supra*, § 485.

the soundness of this proposition ² *Imperial Land Co. of Marseilles*, 11 Eq. 478.

instruments and of lending the quality of negotiability to instruments which may be lacking in some of the essentials of a promissory note or bill of exchange. Hence, as the universal mercantile custom treats bonds and debentures as negotiable, they will be so treated by the courts.¹ This is indeed laying the axe at the root of the tree. The broad proposition that the law merchant is not stereotyped, but is capable of growth and expansion, is sufficient to dispose of any possible objections to the negotiability of instruments, such as bonds and debentures, that are dealt in on the stock exchange and treated as negotiable by business men. Such a comprehensive principle justifies the encomiums that have been heaped upon the common law for its adaptability to changing circumstances, and may well be referred to with pride by admirers of that system of jurisprudence.

§ 1735. *American Cases.* — The broad principle of the elasticity of the law merchant and its capacity to lend the attribute of negotiability to any form of security — even such as was quite unknown at common law — was established in America by a decision of the Supreme Court of the United States almost fifty years in advance of its acceptance in England.² Said Mr. Jus-

¹ *Bechuanaland Exploration Co. v. London Trading Bank* (1898), 2 Q. B. 658 (overruling *Crouch v. Credit Foncier of England*, L. R. 8 Q. B. 374); *Edelstein v. Schuler & Co.* (1902), 2 K. B. 144.

See also *Goodwin v. Robarts*, 1 A. C. 476; L. R. 10 Ex. 337.

² *White v. Vermont & Mass. R. R. Co.*, 21 How. 575; *Mercer County v. Hackett*, 1 Wall. 83.

The negotiability of corporation bonds has been sustained in numerous other cases. *Morris Canal, etc. Co. v. Fisher*, 9 N. J. Eq. 667; 64 Am. Dec. 423; *American Nat. Bank v. American Wood Paper Co.*, 19 R. I. 149; 32 Atl. 305; 61 Am. St. Rep. 746; 29 L. R. A. 103; *Reid v. Bank of Mobile*, 70 Ala. 199; *Re Talahassee Mfg. Co.*, 64 Ala. 567, 592-593; *Junction R. R. Co. v. Cleneay*, 13 Ind. 161; *New Albany, etc. Co. v. Smith*, 23 Ind. 353; *Brain-*

erd v. New York, etc. R. R. Co., 25 N. Y. 496; *Craig v. Vicksburg*, 31 Miss. 216; *Morris Canal, etc. Co. v. Lewis*, 12 N. J. Eq. 323; *Guilford v. Minneapolis, etc. Ry. Co.*, 48 Minn. 560; 51 N. W. 658; 31 Am. St. Rep. 694; *Langston v. S. Car. R. R. Co.*, 2 S. Car. 248; *Gibson v. Lenhardt*, 101 Pa. St. 522; *Carpenter v. Rommel*, 5 Phila. 34; *Gilbough v. Norfolk, etc. R. R. Co.*, 1 Hughes 410; *Soc. for Savings v. New London*, 29 Conn. 174; *Hoskins v. Seaside, etc. Ice Co.* (N. J.), 59 Atl. 645.

Cf. *Carr v. Le Fevre*, 27 Pa. St. 413; *Bunting's Admrs. v. Camden, etc. R. R. Co.*, 81 Pa. St. 254.

The few early cases to the contrary can be explained on the ground that no mercantile custom to treat bonds as negotiable had then been established. *Clark v. Farmers' Mfg. Co.*, 15 Wend. (N. Y.) 256. Some dicta in *Jackson v. Y. & C. R. R.*

tice Grier, speaking for the court, in *Mercer County v. Hackett*:¹ "Usages of trade and commerce are acknowledged by the courts as part of the common law, although they may have been unknown to Bracton or Blackstone. And this malleability to suit necessities and usages of the mercantile and commercial world is one of the most valuable characteristics of the common law." Americans may well pride themselves upon the fact that this enlightened principle was so clearly laid down by their highest court at such an early period in the history of this branch of jurisprudence.

§ 1736. **Whether Uncertainty as to Time, Manner, or Amount of Payment destroys Negotiability.**—This broad principle of negotiability by mercantile custom is, as we have pointed out above, sufficient to overcome any objection whatsoever to the negotiability of securities which are treated as negotiable by the universal custom of the mercantile world. It disposes not merely of the objection that bonds and debentures of corporations are under seal, but also of any objection founded on a real or supposed want of any other of the formal requisites of a promissory note. For instance, by virtue of the principle, a bond or debenture which by reason of some condition or uncertainty affecting the amount or manner of payment lacks an essential characteristic of a promissory note may nevertheless be negotiable.² To be sure, in a case relating to a railway bond,³ the United States Supreme Court said: "The uncertainty of the amount payable . . . is of itself a defect which deprives these instruments of the character of negotiability. As they stand, they amount to a promise to pay so many pounds or so many

Co., 48 Me. 147, are more difficult to explain, as are also a line of Kentucky decisions. *Richie v. Cralle*, 108 Ky. 483; 56 S. W. 963; *Georgetown Water Co. v. Fidelity Trust, etc. Co.*, 78 S. W. 113; 117 Ky. 325. Some American cases go upon the narrower ground that the affixture of the seal may be treated in the case of a corporation as a mere signature, not making the instruments specialties. *Pittsburgh, etc. Ry. Co. v. Lynde*, 55 Oh. St. 23, 47-49; 44 N. E. 596. Cf. *supra*, § 1733 and § 485, and *Blake v. Super-*

visors of Livingston Co., 61 Barb. 149. A bond payable to the registered holder is negotiable as well as a bearer bond: *infra*, § 1743.

¹ *Mercer County v. Hackett*, 1 Wall. 83, 95.

² *Bechuanaland Exploration Co. v. London Trading Bank* (1898), 2 Q. B. 658; *supra*, § 1734.

Cf. *Dickerman v. Northern Trust Co.*, 176 U. S. 181, 194-195; 20 Sup. Ct. 311.

³ *Parsons v. Jackson*, 99 U. S. 434, 439-440.

dollars, — without saying which. One of the first rules in regard to negotiable paper is that the amount to be paid must be certain, and not be made to depend on a contingency." This remark, however, was a mere dictum, as other reasons abundantly sufficient to support the decision were assigned by the court. Accordingly, it is submitted that in America as in England no such objection would be held fatal to negotiability in opposition to a proved clear and uniform commercial usage to the contrary.¹ The only qualification should be that the usage must be reasonable.

§ 1737. **Judicial Notice of Custom to treat Bonds and Debentures as Negotiable.** — In the English cases establishing the power of reasonable mercantile usage to cover any and all objections to the negotiability of bonds and debentures of incorporated companies, it was thought necessary to offer definite evidence by the testimony of merchants and stock brokers to prove the mercantile custom to treat the securities in question as negotiable.² In the United States, however, such proof is not necessary in the case of the ordinary corporation bond; for the usage is so general that the courts are justified in taking judicial notice thereof. Moreover, in the very latest English case on the subject, the court declared that the courts would now take judicial notice of the negotiability of such instruments without proof.³ If, however, the negotiability of some instrument containing peculiar conditions or other extraordinary features were in question, prudence would dictate that even in America affirmative evidence of commercial custom should be adduced.

§ 1738. **Statute making Choses in Action assignable subject to Equities not applicable to Corporation Bonds.** — The negotiability of a coupon bond payable to bearer, being dependent upon the tenor of the instrument effectuated by mercantile custom in spite of technical rules of the common law, is unaffected by a

¹ But see *McClelland v. Norfolk Southern R. R. Co.*, 110 N. Y. 469, 475-476; 18 N. E. 237; 6 Am. St. Rep. 397; 1 L. R. A. 299; *Chouteau v. Allen*, 70 Mo. 290, 339; *Guilford v. Minneapolis, etc. Ry. Co.*, 48 Minn. 560; 51 N. W. 658; 31 Am. St. Rep. 694; *Jackson v. Vicksburg, etc. R. R. Co.*, 2 Woods 141; *Ledwich v. McKim*, 53 N. Y. 307; *Augusta Bank v. Augusta*, 49 Me. 507, 522-523. See also *infra*, § 1740 A.

² *Bechuanaland Exploration Co. v. London Trading Bank* (1898), 2 Ch. 658; *Edelstein v. Schuler & Co.* (1902), 2 K. B. 144.

³ *Edelstein v. Schuler & Co.* (1902), 2 K. B. 144.

statute making *choses in action* assignable but providing that the assignee shall take subject to any defences that would have been available against the assignor.¹ The bearer of a negotiable coupon bond is not an assignee within the meaning of such a statute, but claims directly according to the tenor of the original instrument.

§ 1739. **Statute making Bonds assignable by Transfer on the Company's Books.** — A statute making certain railway bonds assignable by registration of the transfer on the company's books makes them negotiable, and does not merely give the assignee the right to sue in the assignor's name.² Moreover, under such a statute, the assignee does not have an option either to sue in his own name or that of the assignor; for a suit in the assignor's name cannot be sustained.³

§ 1740. **Negotiability after Commencement of Winding-up or Liquidation Proceedings.** — The negotiability of a bond or debenture continues even after the commencement of winding-up proceedings.⁴ Hence, a transferee of a debenture is entitled to prove against the company in the winding-up in spite of the fact that his transferor was largely indebted to the corporation on account of misfeasance as director, and although the transfer took place after institution of the liquidation and after a judgment for the enforcement of the debenture-holders' security.⁵ This result is particularly remarkable because the principal of English debentures becomes due on the institution of winding-up proceedings,⁶ and hence the case involves a decision that a transferee of an overdue debenture does not necessarily take subject to all equities between prior parties.⁷

¹ *Louisville, etc. R. R. Co. v. Ohio Valley Imp., etc. Co.*, 69 Fed. 431, 435-436. But see *Ex parte Mackenzie*, 7 Eq. 240.

² *Vertue v. East Anglian Rys. Co.*, 19 L. J. Ex. 235. As to transfer of registered bonds, see further, *infra*, § 1741 et seq.

³ *Vertue v. East Anglian Rys. Co.*, 19 L. J. Ex. 235.

⁴ *Goy & Co. (1900)*, 2 Ch. 149; *Imperial Land Co. of Marseilles*, 11 Eq. 478.

Cf. Fidelity, etc. Co. v. Roanoke Iron Co., 81 Fed. 439, 448-449.

⁵ *Goy & Co. (1900)*, 2 Ch. 149. Contra: where the transferee has actual notice of the transferor's indebtedness. *Hynes v. Illinois Trust, etc. Bank*, 80 N. E. 753; 226 Ill. 95.

⁶ *Hodson v. Tea Co.*, 14 Ch. D. 859. See *infra*, § 1814.

⁷ See *infra*, § 1753.

§ 1740 A. **Application of the Negotiable Instruments Law.** — The Negotiable Instruments Law, which has been adopted in a large number of states, may have a disturbing effect upon the negotiability of some corporation bonds and debentures. The Act provides that “an instrument to be negotiable must conform” to certain specified requirements. Does this provision apply to instruments other than promissory notes, bills of exchange and similar securities, so that no corporation bonds which fail to conform to the statutory requirements can possess the attribute of negotiability, notwithstanding the fact that such instruments may have been treated as negotiable by mercantile custom? Such a hard and fast rule would certainly be unfortunate, and unsuited to the genius of a commercial people.

The English Act, upon which the American Law is in some respects modelled, was more cautious in this particular. It defined the requisites of negotiable bills of exchange, promissory notes and cheques; but did not attempt in sweeping terms to provide that no instrument which might not conform to those requisites should be negotiable. Accordingly, as we have seen, a debenture issued by an English company, which by reason of uncertainty imported into it by some of the endorsed conditions does not comply with the statutory requisites of a promissory note, may nevertheless become negotiable by an established mercantile usage.¹

It is submitted that the courts of those states in which the Negotiable Instruments Law has been adopted should struggle to reach the same conclusion. The Act, if construed otherwise, would abrogate the noblest characteristic of the common law, its adaptability to new commercial conditions, and substitute a rule of Chinese stagnation. Being in derogation of the common law, the Act should be construed strictly. So, Senator Daniel is of opinion that statutory tests of negotiability should not be construed to apply to coupon bonds.² Nevertheless, the sweeping language of the Negotiable Instruments Law is hard to avoid.³

¹ Supra, § 1735.

² 2 Daniel on Negotiable Instruments, § 1501 a.

³ Note particularly § 84 (4) which expressly provides that one provision of the Act shall not “apply to

persons negotiating public or corporate securities other than bills and notes,” thus apparently indicating that the other provisions of the Act are intended to apply to coupon bonds.

Inconveniences to be encountered from applying the Negotiable Instruments Law to coupon bonds may be discerned on every hand. To take a concrete example, the year after the passage of that Law by the State of Maryland, the corporation operating the street railways of the City of Baltimore issued a large number of income bonds which are to be redeemable at the option of the company after a certain date, but which by their terms are never to mature except upon default by the company in paying principal or interest of certain underlying mortgage bonds. The interest on the income bonds is represented by coupons, which, however, are payable only in the event that sufficient income is earned by the company. It is quite clear that neither bonds nor coupons possess that degree of certainty in regard to payment which by the Negotiable Instruments Law is made a condition of negotiability. They are, however, constantly dealt in on the stock exchange, and are treated by brokers and others as negotiable instruments. Does the statute require that notwithstanding this clear and uniform usage, the instruments must be held to be non-negotiable? At common law, the mercantile custom might be recognized; and as the statute does not in express terms provide that the custom of merchants must be disregarded, it is submitted that the courts should adhere to the safe and beneficial principles of the common law.

Another illustration is afforded by a recent New York case. The Adams Express Company, which is an unincorporated joint-stock company, had issued a series of coupon bonds which by their terms were payable to bearer but which provided that the holders of the bonds and coupons should look exclusively to the joint property for payment and that the several members or partners should incur no personal liability. It was objected that the bonds were a mere "promise to pay out of a particular fund," namely, the joint assets of the association, and therefore by the express terms of the Negotiable Instruments Law were non-negotiable. The majority of the New York court overruled this contention, but on the ground that the company was a quasi legal entity, and that therefore the obligation of the company to pay out of its funds was a personal obligation and not, within the meaning of the Negotiable Instruments Law, a mere promise to pay out of a particular fund.

§ 1741-§ 1748. METHOD OF TRANSFER.

§ 1741. **In general — Bearer Bonds and Registered Bonds.** — In England, debentures are usually payable to the registered holder for the time being.¹ In America, bonds are commonly payable to bearer but with a provision giving the holder an option to have them registered and thus made payable to the registered holder.² A failure to exercise such an option cannot be deemed negligence on the part of the holder.³

§ 1742-§ 1745. *Registered Bonds or Debentures.*

§ 1742. **In general — Effect of unregistered Transfer.** — Where bonds or debentures either by exercise of an option on the part of the holder to have them registered or by the original terms of their issue are payable to the registered holder, actual registration of a transfer is not in all cases necessary in order to entitle a transferee to the rights of a *bona fide* purchaser, at least as against the company: it is sufficient if the transfer has been duly presented for registration to the corporation or its official liquidator, and registration has been inexcusably refused or delayed.⁴ On the other hand, the company is entitled to refuse to register a transfer of registered bonds or debentures because of an equitable defence available against the transferor, and in case of such refusal the transferee cannot either compel registration or without registration lay successful claim to the rights of a *bona fide* purchaser of a negotiable instrument.⁵ *A fortiori*, where registered bonds or debentures are deposited as collateral security for a debt without the execution of any transfer, and no

¹ The English practice is occasioned by a heavy tax on bearer debentures.

² Cf. *Savannah, etc. R. R. Co. v. Lancaster*, 62 Ala. 555.

³ *Bechuanaland, etc. Co. v. London Trading Bank* (1898), 2 Q. B. 658. See particularly p. 661, where the point was made by counsel for defendant as a ground for raising an estoppel by negligence, and pp. 678-

679, where the court held that no estoppel could be raised, although without adverting to this particular ground therefor. Cf. *Cooper v. Illinois Central R. R. Co.*, 38 N. Y. App. Div. 22, 27-28; 57 N. Y. Supp. 925.

⁴ *Goy & Co.* (1900), 2 Ch. 149; *Lishman's Claim*, 23 L. T. 40.

⁵ *Palmer's Decoration, etc. Co.* (1904), 2 Ch. 743.

notice of the hypothecation is given to the company, the company may set off against its liability or the debentures a claim against the registered holder.¹ Where a bond belonging to a decedent's estate is registered in the name of the executor, who was named in the will as trustee, it has been said that on the completion of the administration the title will pass to the executor as trustee and upon his death will devolve upon his successors in the trust without any entry on the register.²

§ 1743. **Effect of Registration.** — A registered bond or debenture is no less negotiable than a bearer bond.³ The difference is rather in the method of the negotiability. As a bill or note payable to order is negotiable, so is a registered bond or debenture. A transfer by registration is equivalent to a transfer by endorsement of a bill or note. After registration, the company is effectually precluded from raising any equitable defences which would have been available against the transferor. Moreover, the registered transferee cannot, like an assignee of a non-negotiable chose in action, sue in the name of the transferor but can sue in his own name only.⁴

Even, however, a provision in a bond or debenture that it shall be payable to the registered holder for the time being does not prevent the company from setting up against a transferee who has been registered as owner but who has not paid value — for example, an assignee for the benefit of creditors — any defence that would have been available against the transferor.⁵

§ 1744. **Forged Transfers.** — If the company registers a forged transfer of registered debentures, the true owner may file a bill in equity against the transferee to have the transfer cancelled; the transferee cannot defend upon the ground that he was a purchaser for value without notice of the fraud, and that a court of equity should not lend its extraordinary aid against him but should leave the defrauded party to his remedies at law.⁶ In

¹ *Richard Smith & Co.* (1901), Cf. *Scollans v. Rollins*, 173 Mass. 1 Ir. 73. 275.

² *Cooper v. Illinois Central R. R.* ⁴ *Supra*, § 1739.

Co., 38 N. Y. App. Div. 22, 25-26; ⁵ *Brown & Gregory, Ltd.* (1904), 57 N. Y. Supp. 925. 1 Ch. 627. (See also s. c. on appeal (1904), 2 Ch. 448.)

⁶ *Straus v. United Telegram Co.*, 164 Mass. 130; 41 N. E. 57 (resting ⁶ *Cottam v. Eastern Counties Ry. Co.*, 1 J. & H. 243. (Note, however,

general, the same law would no doubt be held to govern the rights of the various parties in the case of a forged transfer of registered bonds or debentures as in the case of a forged transfer of capital stock.¹ The law of the latter subject has been very fully worked out.²

§ 1745. **Discharge of Bonds from Registry — Restoration of Negotiability by Delivery.** — In the case of American bonds there is usually a provision that if the bond is registered the registered holder may, by having an appropriate entry made on the register and noted on the bond, take the instrument out of the registry and make it payable to bearer once more. This may be done without impropriety by a trustee who holds registered bonds;³ for the purposes of the trust may perhaps be promoted by having the securities made more readily salable. But bonds held in trust by several co-trustees cannot lawfully be taken out of registry and made payable to bearer without the concurrence of all the trustees; and if the company at the instance of one only of the trustees takes the bonds out of registry and makes them payable to bearer, thereby enabling that trustee to sell the bonds and convert the proceeds to his own use, it is liable to make good to the *cestui que trust* the loss which he has thus sustained.⁴ Where bonds are registered in the name of a charitable corporation, it has been held that the treasurer of the institution, although charged with the custody of its securities, has no authority to have a registered bond made payable to bearer.⁵ If the bonds are taken out of the registry and made payable to bearer in

that this was an early case before *etc. Ry. Co.*, 182 N. Y. 47; 74 N. E. 571.)

¹ *Clarkson Home v. Chesapeake, etc. Ry. Co.*, 92 N. Y. App. Div. 491, 499; 87 N. Y. Supp. 348 (where the court said that the effect of registration "was to place registered bonds and shares of stock of a corporation upon a similar footing, so that the owner of the bonds when registered should be protected from loss, theft, or embezzlement"), affirmed 182 N. Y. 507; 74 N. E. 1118; *Clarkson Home v. Missouri,*

etc. Ry. Co., 182 N. Y. 47; 74 N. E. 571.

² See *supra*, § 904-§ 906.

³ *Cooper v. Illinois Central R. R. Co.*, 38 N. Y. App. Div. 22, 27-28; 57 N. Y. Supp. 925.

⁴ *Cooper v. Illinois Central R. R. Co.*, 38 N. Y. App. Div. 22; 57 N. Y. Supp. 925.

⁵ *Clarkson Home v. Chesapeake, etc. Ry. Co.*, 92 N. Y. App. Div. 491; 87 N. Y. Supp. 348, affirmed 182 N. Y. 507; 74 N. E. 1118; *Clarkson Home v. Missouri, etc. Ry. Co.*, 182 N. Y. 47; 74 N. E. 571.

pursuance of a forged order, the company remains liable to the true owner as if no change in the registry had taken place.¹

§ 1746. **Instruments payable to "A or his Assigns."** — Where a bond is payable to A or his assigns, an assignment in blank by the payee makes the instrument practically payable to the bearer.² But on the other hand, a federal judge held that by the law and practice of Virginia, a bond payable to A or his assigns is not negotiable.³ In an early New York case, the judge expressed the opinion that a corporation bond payable to A or his assigns was assignable by mere delivery but was not negotiable;⁴ but this dictum having been pronounced before the rise of the modern law of corporation bonds can hardly be deemed of much authority at the present day.

§ 1747. **Instruments in which a Blank is left for Name of Payee.** — The issue of a bond with a blank for the name of the payee makes the instrument virtually payable to bearer, and gives the latter a right to fill up the blank in spite of the fact that the bond is under the corporate seal.⁵ Indeed, even a bond which on its face is described as a registered bond and which bears a certificate of registration is nevertheless negotiable by mere delivery if a blank is left for the name of the payee.⁶

¹ *Clarkson Home v. Chesapeake, etc. Ry. Co.*, 92 N. Y. App. Div. 491; 87 N. Y. Supp. 348; affirmed in 182 N. Y. 507; 74 N. E. 1118; *Clarkson Home v. Missouri, etc. Ry. Co.*, 182 N. Y. 47; 74 N. E. 571. These cases also relate to the liability of a broker who sells the bonds on the forger's order and pays the purchase price to him.

² *Brainerd v. New York, etc. R. R. Co.*, 25 N. Y. 496.

³ *Cronin v. Patrick County*, 89 Fed. 79.

⁴ *Barry v. Merchants' Exchange Co.*, 1 Sandf. Ch. (N. Y.) 280, 313.

⁵ *White v. Vermont & Mass. R. R. Co.*, 21 How. 575; *Hubbard v. New York, etc. R. R. Co.*, 36 Barb. (N. Y.) 286; *Boyd v. Kennedy*, 38 N. J. Law

146; *Keene Five Cent Savings Bank v. Lyon County*, 90 Fed. 523 (bond with blank for name of payee held payable to bearer for purposes of jurisdiction of federal courts); *Manhattan Sav. Inst. v. Nat. Exchange Bank*, 42 N. Y. App. Div. 147.

Cf. *Chapin v. Vermont, etc. R. R. Co.*, 8 Gray (Mass.) 575 (where the issue of the bonds was confirmed by a special act of the legislature); *D'Esterre v. City of Brooklyn*, 90 Fed. 586.

But see *Perth Electric Tramways* (1906), 2 Ch. 216 (where it was thought that the issue of blank debentures was a contract to issue complete debentures).

⁶ *D'Esterre v. City of Brooklyn*, 90 Fed. 586.

§ 1748. **Endorsement of Bonds and Debentures by Transferor.** — Ordinary bonds or debentures do not contemplate endorsement by a transferor; and therefore even if a transferor should write his name thereon he would probably not incur the liability of an endorser of commercial paper. Possibly he might be held as guarantor,¹ unless the Statute of Frauds were held to constitute an obstacle. On the other hand, where bonds are payable to A or his assigns, it may well be that the payee would be liable as endorser upon a written assignment.² A corporation which owns bonds of another company has power to endorse or guarantee them whenever so to do is the most advantageous method of effecting a transfer.³

§ 1749-§ 1758. INCIDENTS AND CONSEQUENCES OF NEGOTIABILITY OF BONDS AND DEBENTURES.

§ 1749. **In general — Application of Law of Bills and Notes.** — The incidents and consequences of negotiability are, in the main, the same in the case of corporation bonds or debentures as in the case of ordinary bills of exchange or promissory notes. For instance, in both cases the same rules govern the question who is entitled to the rights of a *bona fide* purchaser;⁴ the question whether the burden of proving payment of value rests upon the transferee;⁵ the question whether the burden of proving notice

¹ *Codman v. Vermont, etc. R. R. Co.*, 16 Blatchf. 165.

Cf. *Atchison, etc. R. R. Co. v. Fletcher*, 35 Kans. 236; 10 Pac. 596; *Rogers, etc. Works v. Southern R. R. Ass'n*, 34 Fed. 278.

² *Madison, etc. R. R. Co. v. Norwich Sav. Soc.*, 24 Ind. 457; *Bonner v. City of New Orleans*, 2 Woods 135.

³ *Tod v. Kentucky Union Land Co.*, 57 Fed. 47; 6 C. C. A. 685 (affirmed in *Marbury v. Kentucky Union Land Co.*, 62 Fed. 335, 350-351; 10 C. C. A. 393). See *supra*, § 77.

⁴ *Cromwell v. County of Sac*, 96 U. S. 51 (a case of municipal bonds); *Thomas v. Brownville, etc. R. R. Co.*, 109 U. S. 522, 524-525 (headnote misleading); 3 Sup. Ct. 315; *Guaranty Trust, etc. Co. v. Green Cove, etc. R. R. Co.*, 139 U. S. 137, 149-150;

11 Sup. Ct. 512; *Reid v. Bank of Mobile*, 70 Ala. 199; *Welch v. Sage*, 47 N. Y. 143; 7 Am. Rep. 423; *Spence v. Mobile, etc. Ry. Co.*, 79 Ala. 576; *Central R. R., etc. Co. v. Farmers' L. & T. Co.*, 116 Fed. 700; *Rondot v. Rogers Tp.*, 99 Fed. 202; 39 C. C. A. 462; *Lembeck v. Jarvis, etc. Storage Co.* (N. J.), 64 Atl. 126; *London Joint Stock Bank v. Simmons* (1892), A. C. 201 (as to a pledge by a broker of hypothecated bonds and other securities *en bloc* to a person who made no inquiries).

⁵ *Simmons v. Taylor*, 38 Fed. 682 (reversed on other grounds *sub nom. Simmons v. Burlington, etc. Ry. Co.*, 159 U. S. 278; 16 Sup. Ct. 1); *Shellenberger v. Altoona, etc. R. R. Co.*, 212 Pa. 413; 61 Atl. 1000; 108 Am. St. Rep. 876.

rests upon the company, or that of proving *bona fides* upon the purchaser;¹ the question whether a purchaser for value may recover the full amount of the instrument irrespective of the amount he may have paid therefor;² the question what defences are cut off by purchase for value,³ and all the multitudinous other questions of the same general nature.⁴

§ 1750-§ 1753. *Constructive Notice to Transferee of Bonds or Debentures.*

§ 1750. **In general — Points peculiar to Corporation Bonds.** — Occasionally, however, questions arise which grow out of the peculiar features of corporate bonds and debentures and which therefore cannot come up in respect to bills and notes. Particularly is this true in regard to questions of constructive notice.⁵ For instance, the contention has been advanced, although overruled by the courts, that notice to one of the trustees under the covering mortgage or deed of trust of irregularities in the issue of certain municipal securities owned by the company and included in the mortgage will prevent the bondholders from claiming the rights of *bona fide* purchasers in respect to such securities.⁶

§ 1751. **Effect of Alterations or Erasures in Bonds, and other Imperfections apparent on Face of Instruments.** — Alterations or erasures in the bonds, especially in those parts of the bonds by which their identity might be traced, may well be held in some cases a sufficiently suspicious circumstance to charge a purchaser with notice of some defect in his transferor's title. Much must depend on the particular circumstances of each case. In

¹ *Murray v. Lardner*, 2 Wall. 110; 892; *Cromwell v. County of Sac*, 96 Hotel Co. v. Wade, 97 U. S. 13, 24 U. S. 51, 59-60.

(headnote inadequate); *Edwards v. Bates County*, 117 Fed. 526; *Pickens Tp. v. Post*, 99 Fed. 659; *Farmers' L. & T. Co. v. Madison Mfg. Co.*, 153 Fed. 310. ³ *Parsons v. Jackson*, 99 U. S. 434.

⁴ As to the application of the Negotiable Instruments Law, compare supra, § 1740 A.

⁵ See also infra, § 1845, as to constructive notice of contents of the covering deed of trust.

⁶ *Railroad Companies v. Schutte*, 103 U. S. 118, 144-145 (headnote inadequate); *Wade v. Chicago, etc. R. R. Co.*, 149 U. S. 327; 13 Sup. Ct. *Commissioners of Johnson County v. Thayer*, 94 U. S. 631. See infra, § 1830, for discussion of this question.

one case, a supposed alteration in the numbers of the bonds was held to be insufficient to charge a purchaser with notice.¹

Where the alteration is not apparent on the face of the instrument, there is nothing to charge a transferee with notice of an irregularity; but if the alteration is made by the holder fraudulently and in a material particular, it would seem that according to the general principles applicable to negotiable instruments, the company should be discharged. An alteration in the numbers of the bonds is not ordinarily for this purpose deemed material,² unless the numbers are to be used, for determining the bonds which are to be subject to redemption or other special conditions.³

Where bonds as originally issued bore attached to them certain certificates stating that upon surrender of the bonds the holders would be entitled to full-paid preferred stock, the absence of these certificates, although they were referred to in the body of the bond, is not a sufficiently suspicious circumstance to put a purchaser on his guard and therefore deprive him of the rights of a *bona fide* holder.⁴

§ 1752. **Notice by *Lis Pendens*.** — Corporation bonds and debentures, like other negotiable paper, are exempt from the doctrine of constructive notice by *lis pendens*, so that a purchaser of a bond before maturity without actual notice of the pendency of a suit to enjoin the transfer of the securities because of fraud in their issue gets a good title.⁵

§ 1753. **Transfer of overdue Bonds.** — As to bills and notes, the law has been long settled that a transferee after maturity takes subject to all defences available as between the prior parties. This rule is based upon the theory that the purchaser of dishonored paper is chargeable with notice that something is wrong. In the nature of things, there would seem no reason to doubt that the principle applies to bonds and debentures of corporations,

¹ *Birdsall v. Russell*, 29 N. Y. 220.

² *Wylie v. Missouri Pac. Ry. Co.*, 41 Fed. 623; *Commonwealth v. Bank*, 98 Mass. 12; *City of Elizabeth v. Force*, 29 N. J. Eq. 587. Cf. *Morgan v. U. S.*, 113 U. S. 476.

But see *Suffell v. Bank of England*, 9 Q. B. D. 555.

³ *Wylie v. Missouri Pac. Ry. Co.*, 41 Fed. 623, 624 (semble).

⁴ *Welch v. Sage*, 47 N. Y. 143; 7 Am. Rep. 423.

Cf. *Hotchkiss v. National Banks*, 21 Wall. 354, 359.

⁵ *Durant v. Iowa County*, 1 Woolw. 69; *Farmers' L. & T. Co. v. Toledo, etc. R. R. Co.*, 54 Fed. 759.

See also *Farmers', etc. Bank v. Waco Electric Ry. Co. (Tex.)*, 36 S. W. Rep. 131; *Pickens Tp. v. Post*, 99 Fed. 659.

and a number of cases proceed on that assumption.¹ However, in one English case the contrary seems to have been impliedly held.² At all events, a bond is not to be deemed overdue or dishonored so as to prevent a transfer free of equities between prior parties merely because overdue interest-coupons were attached to the bond at the time of the transfer;³ and this is true although the bonds provide that the principal shall become due if default in payment of interest continue for six months or some other definite time after demand.⁴ Even if the presence of overdue coupons were sufficient to put a purchaser on inquiry, he could not be deprived of the rights of a *bona fide* holder for value if an inquiry would have revealed a satisfactory explanation for the failure to collect the coupons.⁵ Bonds redeemable at the option of the obligor after a certain date but not absolutely payable until a later date are not overdue so as to charge a purchaser with notice of defects in their issue, or in the title thereto, until the later date.⁶

¹ *Texas v. White*, 7 Wall. 700, 735; *Morgan v. U. S.*, 113 U. S. 476; 5 Sup. Ct. 588 (both being cases of U. S. government bonds); *Edwards v. Bates County*, 117 Fed. 526.

Cf. *Young v. MacNider*, 25 Can. Sup. Ct. Rep. 272; *American L. & T. Co. v. St. Louis, etc. Ry. Co.*, 42 Fed. 819; *Central R. R., etc. Co. v. Farmers' L. & T. Co.*, 116 Fed. 700 (headnote inadequate). See also *infra*, § 1793 (as to overdue coupons).

² *Supra*, § 1740.

³ *Cromwell v. County of Sac*, 96 U. S. 51; *Railway Co. v. Sprague*, 103 U. S. 756 (distinguishing *Parsons v. Jackson*, 99 U. S. 434); *McLane v. Placerville, etc. R. R. Co.*, 66 Cal. 606, 632; 6 Pac. 748; *Rouede v. Jersey City*, 18 Fed. 719; *Long Island, etc. Trust Co. v. Columbus, etc. Ry. Co.*, 65 Fed. 455; *State v. Brown*, 64 Md. 199, 208; 1 Atl. 54; 6 Atl. 172; *Central R. R., etc. Co. v. Farmers' L. & T. Co.*, 116 Fed. 700.

Cf. *Simmons v. Taylor*, 38 Fed. 682 (reversed on other grounds, *sub nom. Simmons v. Burlington, etc.*

Ry. Co., 159 U. S. 278; 16 Sup. Ct. 1); *National Bank of N. America v. Kirby*, 108 Mass. 497; *Morton v. New Orleans, etc. Ry. Co.*, 79 Ala. 590, 612-617; *First Nat. Bank v. Taliaferro*, 72 Md. 164, 171-172.

But see *Chouteau v. Allen*, 70 Mo. 290, 339-340; *First National Bank v. County Comm'rs of Scott Co.*, 14 Minn. 77; 100 Am. Dec. 194. In *Gilbough v. Norfolk, etc. R. R. Co.*, 1 Hughes 410, a transferee of a bond with overdue coupons attached was accorded the rights of a purchaser for value as to the bond and unmatured coupons, but not as to the overdue coupons.

⁴ *Railway Co. v. Sprague*, 103 U. S. 756; *Morton v. New Orleans, etc. Ry. Co.*, 79 Ala. 590, 617-619.

Cf. *Pittsburgh, etc. Ry. Co. v. Lynde*, 55 Oh. St. 23, 50-51; 44 N. E. 596.

⁵ *Railway Co. v. Sprague*, 103 U. S. 756, 762-763. One may, perhaps, be permitted to question the soundness of this dictum.

⁶ Cf. *Morgan v. U. S.*, 113 U. S. 476; 5 Sup. Ct. 588, overruling *Texas v. White*, 7 Wall. 700.

§ 1754-§ 1757. *Extent of Negotiability.*

§ 1754. **Negotiability as regards mortgaged Property.**— In Illinois and in some few other states a regrettable doctrine, contrary to the great weight of authority, has become established by which a *bona fide* purchaser of ordinary commercial paper, as to any rights under a mortgage given to secure it, takes subject to all equities prevailing between the original parties.¹ This doctrine, however, has no application to corporation bonds payable to bearer and secured in the usual way by deed of trust in the nature of a mortgage.² Of course, however, in so far as the mortgage covers non-negotiable choses in action belonging to the corporation even *bona fide* purchasers of the bonds will be subordinated to any equitable defences of the debtor which would be available against the company;³ and this is true quite irrespective of the above Illinois rule and even in jurisdictions where that rule has obtained no foothold.

§ 1755. **As against a Guarantor of the Bonds.**— On principle, it would seem clear that where bonds are guaranteed by another corporation, either before their issue or by way of endorsement upon a transfer, the claim against the guarantor is negotiable as well as that against the principal.⁴

§ 1756. **As against Shareholders in the Company.**— Where the shareholders of the corporation are under some direct statutory liability to creditors, the bonds or debentures of the company are negotiable against the shareholders as well as against the company. That is to say, the shareholders when sued by a *bona fide* purchaser of bonds or debentures cannot

¹ 2 Daniel on Neg. Instr., 5th ed. § 834.

Cf. *Spence v. Mobile, etc. Ry. Co.*, 79 Ala. 576.

² *Peoria, etc. R. R. Co. v. Thompson*, 103 Ill. 187; *Pittsburgh, etc. Ry. Co. v. Lynde*, 55 Oh. St. 23, 51-53; 44 N. E. 596.

³ *Kissel v. Chicago, etc. R. R. Co.*, 44 N. Y. Misc. 156; 89 N. Y. Supp. 796.

⁴ *Atchison, etc. R. R. Co. v. Fletcher*, 35 Kans. 236; 10 Pac. 596; *Toppa v. Cleveland, etc. R. R. Co.*,

1 Flippin 74; *Louisville, etc. Ry. Co. v. Louisville Trust Co.*, 174 U. S. 552; 19 Sup. Ct. 817; *Central Trust Co. v. Indiana, etc. R. Co.*, 98 Fed. 666. Cf. *Bank of Ashland v. Jones*, 16 Oh. St. 145; *Arnot v. Erie Ry. Co.*, 67 N. Y. 315; *Arents v. Commonwealth*, 18 Gratt. (Va.) 750 (holding that the guaranty even if not negotiable at law passes in equity with the bond); *infra*, § 1778.

But see *Eastern Townships Bank v. St. Johnsbury, etc. R. R. Co.*, 40 Fed. 423.

avail of an equitable defence which might have been set up against the original holder. For instance, if the bonds are issued under such circumstances as would preclude the original holder, by estoppel or otherwise, from enforcing the statutory liability of the shareholders, nevertheless a purchaser for value without notice can maintain a suit against the shareholders founded upon their individual statutory liability.¹

§ 1757. **As against senior Encumbrancer who waives Priority conditionally.** — On the other hand, bonds are not negotiable as against a holder of a prior lien who has agreed to waive his priority on certain conditions, and consequently he will not be prevented from showing that those conditions were not complied with by the company, even though the bonds may have passed to purchasers for value without notice of the breach of condition.²

§ 1758. **What Defences cut off by Purchase for Value.** — The question what defences are cut off by purchase for value is the same in the case of corporation bonds as in the case of other negotiable instruments. The defence of *ultra vires*, to be sure, is one which cannot arise in the case of bills or notes executed by individuals or firms; but the effect of purchase for value upon the right to set up this defence has been considered above.³

§ 1759. **What passes by Transfer of Bonds or Debentures.** — A federal judge once held that a claim of a bondholder against the trustee of the mortgage for failure properly to account for trust moneys does not upon a transfer of the bonds pass to the transferee without an express agreement to that effect.⁴ But in view of the difficulty, not to say impossibility, of determining who was the owner at any given time of an ordinary coupon bond, payable to bearer, it is submitted that this decision, if followed by other courts, would introduce an unfortunate element of

¹ *American File Co. v. Garrett*, affirmed short, 176 N. Y. 546; 68 110 U. S. 288, 293-294 (headnote N. E. 1115.
inadequate); 4 Sup. Ct. 90.

³ *Supra*, § 1703.

² *Central Trust Co. v. New York, etc. Water Co.*, 74 N. Y. Supp. 135,

⁴ *Dwight v. Smith*, 9 Fed. 795.

confusion into the law. A transfer of a bond should invest the transferee with every right which the transferor possessed by virtue of his ownership of the bond. Whether the right of the transferor to prior coupons is an exception to this rule will be considered below.¹

§ 1760. **Pledge or Hypothecation of Bonds and Debentures.** — The law is generally settled that the pledgee of negotiable paper, unlike a pledgee of chattels or of public stocks, has no implied power of sale in case of default.² The pledgee is expected to wait until the paper falls due rather than run the hazard of a forced sale. But since corporation bonds are usually payable at so distant a date that the pledgor cannot have contemplated the collection thereof as the only means of enforcing the pledge, and since they have usually a recognized market value, it is held that the pledgee of bonds does have an implied power of sale.³ The same rule applies where the company itself is the pledgor, and even though the company is thrown into the hands of a receiver or liquidator before the sale is made.⁴

§ 1761. **Contracts for Sale or Transfer of Bonds and Debentures.** — A contract for the sale of debentures secured by a floating charge on real estate has been held in England to be an agreement for the sale of an interest in land within the fourth section of the Statute of Frauds.⁵ In this case, however, the charge was created by the debentures themselves and not, as is the American custom, by a covering deed of trust. It is, therefore, submitted that even if the English case above referred to be sound — a point about which some doubt may be permitted — it would be distinguishable from a case relating to a contract for the sale of ordinary American corporation bonds. Moreover, in several cases, a bequest of English railway debentures has been held not to be a devise of an interest in land within the meaning of the Mortmain Acts;⁶ but these cases proceed upon the ground that

¹ *Infra*, § 1771. And compare *v. Scioto Fire Brick Co.*, 82 Ill. § 1780, § 1781. 548.

² *Jones on Pledges*, § 651.

³ *Morris Canal, etc. Co. v. Lewis*, 12 N. J. Eq. 323; *Jerome v. McCarter*, 94 U. S. 734, 739 (headnote inadequate); *Brown v. Ward*, 3 Duer (N. Y.) 660; *Alexandria, etc. R.R. Co. v. Burke*, 22 Gratt. (Va.) 254.

But see *contra*: *Joliet Iron Co.*

⁴ *Fidelity, etc. Co. v. Roanoke Iron Co.*, 81 Fed. 439, 448-449.

⁵ *Driver v. Broad* (1893), 1 Q. B. 744.

⁶ *Cf. Toppin v. Lomas*, 16 C. B. 145.

⁶ *Attree v. Hawe*, 9 Ch. D. 337; *Re Mitchell*, 6 Ch. D. 655; *Holds-worth v. Davenport*, 3 Ch. D. 185.

such debentures charge only the income and profits of the land, and therefore while they may have some bearing upon American income bonds have little or no relevancy to ordinary mortgage bonds charged upon the corpus as well as the income of the company's property. Very clearly ordinary corporation mortgage bonds are so far personal property that a seller thereof has no vendor's lien for the purchase price.¹

In any contract for sale of bonds, there is an implied warranty of title on the part of the vendor and also an implied warranty of genuineness or identity of the thing sold² but there is no implied warranty that the corporation had authority to issue the series to which the bonds sold belong.³

§ 1762. **Equitable Interests in Bonds and Debentures.**—Of course, while delivery of a bond or debenture payable to bearer, or registration of the transfer of a bond payable to the registered holder, is necessary in order to perfect an assignment of the legal title, yet the equitable title may be transferred in many other ways. In such a case, the equitable transferee or *cestui que trust* has the same rights as any equitable transferee or *cestui que trust* of a chose in action. Sometimes, companies have sought to relieve themselves of the obligation to respect the rights of an equitable owner of a bond or debenture by inserting a clause in the instrument providing that the corporation shall not be bound to enter on the register notice of any equity or trust respecting the instruments. If, in spite of such a clause, the company does actually enter notice of an equity or trust on the register, it must subsequently respect the rights of the equitable owner, and therefore cannot set off debts subsequently contracted by the holder of the legal title;⁴ and indeed a doubt has been intimated whether such a clause could in any event diminish the rights of a *cestui que trust* of the bonds or debentures against the company.⁵

§ 1763. **Possession of Bonds as Evidence of Ownership.**—Possession of corporate bonds, payable to bearer, is sufficient *prima facie* evidence of ownership.⁶

¹ *Barstow v. Pine Bluff, etc. Ry.* (1893), 2 Ch. 175 (headnote inadequate). 21 S. W. Rep. 652; 57 Ark. 334 (semble).

² *Meyer v. Richards*, 163 U. S. 385. ⁵ *Christie v. Taunton, etc. Co.* (1893), 2 Ch. 175, 181 (headnote inadequate).

³ *Otis v. Cullum*, 92 U. S. 447. ⁶ *Edwards v. Bates County*, 99

⁴ *Christie v. Taunton, etc. Co.* Fed. 905; 40 C. C. A. 161; *Rondot*

§ 1764-§ 1798. *INTEREST AND INTEREST COUPONS.*

§ 1764. **In general — Dual Nature of Coupons.** — One of the prominent characteristics of the usual corporation bond or debenture is that interest upon the principal sum is payable upon presentation from time to time of severable interest-warrants or coupons originally attached to the instrument itself. These coupons partake of a dual nature. In the first place, they represent interest on the bond or debenture, and have therefore some of the characteristics of interest. Secondly, they are in the nature of independent negotiable instruments. Indeed, their features of this latter sort predominate. We shall, however, first consider the nature of coupons as representing interest on the bond or debenture. The decided cases are not altogether harmonious or consistent in drawing the line between the respects in which a coupon is to be deemed a mere incident of the bond and the respects in which it is to be deemed a separate instrument.

§ 1765-§ 1773. *COUPONS AS INTEREST ON THE PRINCIPAL OF THE BOND.*

§ 1765. **Coupons maturing after Maturity of Bond.** — In England the running of interest on debentures as on other obligations of the company is stopped, if the company be insolvent, by the commencement of an involuntary liquidation or of a winding-up under supervision of the court.¹ This rule, however, depends upon the peculiar nature of winding-up proceedings under the British statute, and cannot have any application, even by analogy, in the United States. After maturity, interest is allowed on bonds or debentures by way of damages at the same rate as before maturity.² Where, however, a judgment is obtained for the principal of a bond or debenture, the original obligation is merged in the judgment, which bears thenceforth the same in-

v. Rogers Tp., 99 Fed. 202; 39 *etc. R. Co.*, 29 Fed. 474; *Beckwith v. Trustees of Hartford, etc. R. R.*, C. C. A. 462. Cf. *infra*, § 1971.

¹ *Imperial Land Co. of Mar-* 29 Conn. 268; 76 Am. Dec. 599.
seilles, 11 Eq. 478.

But see *Langston v. S. Car. R. R. Co.*, 2 S. Car. 248; *Holden v. Trust U. S.* 51; *Ohio v. Frank*, 103 U. S. Co., 100 U. S. 72.

697; *Jackson, etc. Co. v. Burlington*,

terest as other judgments although the bond or debenture may have borne a higher rate.¹ In all of these respects the fact that the interest is represented by coupons is undoubtedly immaterial. In some other respects, the case is not so clear.

§ 1766-§ 1770. *Relative Rights of Tenants for Life and Remaindermen in Coupons.*

§ 1766. **Whether a Coupon is apportionable as to Time — Whether Interest represented by Coupons is deemed to accrue De Die in Diem.** — Interest ordinarily accrues *de die in diem*, and is, therefore, apportionable as between successive owners, such as tenant for life and remainderman. The same rule applies where the debt is secured by a mortgage and where dates for the payment of the interest are fixed. On the other hand, mere annuities or periodic payments are not apportionable. It was early established in England that dividends, or the regular periodic payments, on consols or British government stock are not apportionable but should be treated in this respect like instalments of an annuity.² This is because British consols do not constitute a debt of the government; they never mature, and there is never a time when the holder has the right to demand payment. They constitute rather a perpetual annuity redeemable at the option of the government at any time on the payment of a sum equal to the value of the annuity capitalized at the rate of three per cent. The periodic payments cannot, therefore, be deemed compensation for the use of a capital sum of money.

These considerations do not apply to interest on ordinary bonds or debentures, which do represent debts of the company that issues them; and, accordingly, it has been held in England that interest on debentures is apportionable although represented by periodical coupons, so that where a testator's estate consists in part of coupon bonds or debentures, so much of an interest coupon as accrued prior to his death, although represented by a coupon which was not payable until after his death, is never-

¹ *European Central Ry. Co.*, 4 Ch. D. 33. 96 U. S. 51, where a statute prescribed a different rule.

But see *Cromwell v. County of Sac*, ² *Pearly v. Smith*, 3 Atk. 260; *Sherrard v. Sherrard*, 3 Atk. 502.

theless part of the corpus of the estate as between a tenant for life and the remainderman.¹

On the other hand, the Supreme Court of Massachusetts applying the English cases in which interest on British consols and stock in the public funds was held not to be apportionable, determined that interest on coupon bonds which are bought and sold by way of investment is not apportionable at common law, whether the bonds are issued by the United States, a state, a municipal corporation, or a private corporation such as a railway company.² It is not a little remarkable that the common-law rule by which periodical payments of money by way of rent, annuity, or otherwise, are held not to be apportionable — a rule which is often thought to be contrary to modern ideas of justice, and which the American courts have generally regarded with hostility and followed only when absolutely obliged by precedent to do so — should in this case be applied in America to securities which the English courts regard as apportionable at common law. Moreover, as already pointed out, to assimilate interest on ordinary corporation bonds, or our ordinary American municipal bonds or stocks, to interest on British consols and public stocks or funds, is certainly erroneous. The paucity of authorities in view of the large number of coupon bonds held by trustees is not a little remarkable. Moreover, there seems to be no uniform practice of trustees throughout the United States which could be looked to as an authoritative precedent in the absence of any binding judicial authority.

As the fundamental question whether bonds should be deemed, as between tenant for life and remainderman, to be interest on principal of the bond and as such to accrue *de die in diem* and to be apportionable is not clearly settled, it is not surprising to find that other questions between tenants for life and remaindermen with regard to corporation bonds are involved in obscurity.

§ 1767. Sale of Bond with a partly accrued Coupon — Entire Purchase Price is Capital rather than Income. — If a bond with

¹ *Re Rogers' Trusts*, 1 Dr. & S. 338. tions was held to be non-apportionable).

² *Dexter v. Phillips*, 121 Mass. 178; 23 Am. Rep. 261. See also *Earp's Will*, 1 Pars. Eq. (Pa.) 453 (where interest on the "funded debt" of certain private corporations were held to have been made apportionable, for some purposes, by statute).

the current coupon attached is sold by a trustee under a power or under a decree of a court of equity, it is obvious that the purchase price is augmented to some extent by the accruing interest. The purchaser in effect — to use a term applicable to commercial paper — discounts the current coupon. One might reason, therefore, that so much of the purchase money as represents the current coupon should be treated by the trustee as income. For reasons of convenience, however, the courts refuse to make any such division of the purchase money but treat the whole as corpus of the trust estate.¹ If this working rule were not adopted, it would be necessary for trustees on reinvesting in another bond (unless the investment were made on the very day of maturity of a coupon) to charge the tenant for life with so much of the price paid by them as represents an accruing current coupon.² The expense to the trust estate of such complicated accountings would be so great that the advantage of a theoretically sound system would be overborne. Moreover, it is not a fact that the price of bonds increases ratably from day to day in consequence of the accruing interest coupon. Thus, it is a well-recognized phenomenon that when the day arrives on which a coupon matures so that thereafter a sale is “ex-coupon,” although the market price of the bond goes down somewhat, it does not go down by an amount equal to the value of the coupon which has just matured.

§ 1768. **Rights to Coupons on Bonds which are at a Premium —**
In general. — If bonds are selling at a premium it may be argued that the interest coupons represent not merely income but also the wearing away of the principal, and that therefore the full amount of the coupons should not be paid to the tenant for life, but that a fund should be gradually accumulated out of the coupons as they become due, for the purpose of making good to the corpus of the estate the loss which will accrue on maturity of

¹ *Scholefield v. Redfern*, 32 L. J. Ch. 627, 633. See also *supra*, § 1396. Cf. *Whittmore v. Beekman*, 2 Dem. (N. Y.) 276 (holding that interest paid in advance by the obligor upon redeeming the bonds goes as capital).

² In Massachusetts, where the practice of the stock exchange is to sell bonds at a named price to which

the accrued interest must be added in order to make up the full sum to be paid by the purchaser, it was actually held that in case of a purchase of bonds by a trustee the tenant for life must be charged with the amount paid for accrued interest. *Hemenway v. Hemenway*, 134 Mass. 446.

the principal of the bonds. On the other hand, it may be urged that the premium at which the bonds are selling is due not merely to the attractive rate of interest but also to the security of the principal — that therefore it would be unjust to the tenant for life to require the whole of the premium to be paid out of the interest, and that it is impossible to ascertain how much of the premium should be attributed to the high rate of interest and how much to the security of the principal, so that the only working rule is to pay the entire interest as it accrues to the tenant for life. The authorities are far from harmonious.

§ 1769. *In Cases where the Bonds were Part of the Estate when the Trust was created.* — Where the bonds are part of the trust property when the life estate is created, it seems fairly clear that the intention of the testator or settlor would be best effectuated by paying the full interest to the tenant for life as income without laying by any fund to make good the loss to accrue at maturity.¹ Even if the trustees are at liberty in their discretion to lay by a reasonable fund for that purpose, certainly they are not bound to do so.² *A fortiori* where a testator directs that the “full income” of certain property comprising some coupon bonds which are at a premium shall be paid to a beneficiary during his life, the tenant for life is entitled as of right to the entire amount realized from coupons accruing and maturing during the life estate.³

§ 1770. *In Cases where the Bonds were bought at a Premium by Trustees.* — Where the bonds are not originally part of the trust estate but are bought at a premium by the trustees, there is certainly more reason for requiring the trustees to lay by out of the interest a fund to restore the premium to the corpus at maturity. Undoubtedly, it seems somewhat unjust to permit trustees to pay a premium for a bond having but a few years to run and carrying a high rate of interest when a bond equally secure but carrying a lower rate of interest might be bought for its face value.⁴ Accordingly, some authorities hold that where

¹ *Hemenway v. Hemenway*, 134 Mass. 446.

As to the case where the bonds are not an investment which the trustee is authorized to hold, compare *supra*, p. 1136, n. 5.

² *Robertson v. De Brulatour*, 80 N. E. 938, 943; 188 N. Y. 301.

³ *McLouth v. Hunt*, 154 N. Y. 179; 48 N. E. 548; 39 L. R. A. 230.

⁴ Cf. *Cockburn v. Peel*, 3 De G. F. & J. 170 (where the court refused to

trustees invest trust funds in bonds which are bought at a premium, they must (in absence of a clear direction of the testator or settlor to the contrary) devote a part of the interest to accumulating a fund sufficient to make good the loss of the premium when the bond matures.¹ Other cases hold that they are not obliged to use any part of the interest for that purpose but may pay the whole to the tenant for life,² but that in their discretion they may invest part of the interest to make good the loss at maturity.³ Where this rule is adopted, the trustees' discretion is not affected by the fact that the bonds may have a greater market value at a time when a part of the interest is diverted to the sinking fund than at the time when the bonds were bought;⁴ and if the trustees do not lay by any sum a court of equity may in its discretion at any time during the pendency of the estate for life direct them to do so.⁵ Probably all authorities would agree that if the testator directs the trustees to invest in bonds which can be bought only at a premium the tenant for life is entitled to the full interest.⁶

§ 1771. **Rights of Vendors and Purchasers.** — As between

authorize an investment in such a security); *Equitable Reversionary Int. Soc. v. Fuller*, 1 J. & H. 379 (where the court authorized the investment, the tenant for life being the settlor and the remaindermen mere volunteers); *Waite v. Littlewood*, 41 L. J. Ch. n. s. 636 (where the court said that the trustees having no express power of investment should not invest in redeemable securities at a premium).

¹ *Re Stevens*, 80 N. E. 358; 187 N. Y. 471; *Robertson v. De Brulattour*, 80 N. E. 938, 943; 188 N. Y. 301 (semble).

Cf. *New York Life, etc. Co. v. Kane*, 17 N. Y. App. Div. 542; 45 N. Y. Supp. 543; *Farwell v. Tweddle*, 10 Abb. N. C. (N. Y.) 94 (holding that loss of premium from unexpected redemption of bonds should be borne by the corpus).

² *Hite v. Hite*, 93 Ky. 257, 268-269; 20 S. W. 778; 40 Am. St. Rep. 189; 19 L. R. A. 173.

Cf. *Hemenway v. Hemenway*, 134

Mass. 446 (distinguished in *New England Trust Co. v. Eaton*, 140 Mass. 532, 542-543; 4 N. E. 69; 54 Am. Rep. 493); *Furness's Estate*, 12 Phila. (Pa.) 130.

³ *New England Trust Co. v. Eaton*, 140 Mass. 532; 4 N. E. 69; 54 Am. Rep. 493; *Curtis v. Osborn* (Conn.), 65 Atl. 968 (where the question was left open whether the laying by of a reserve was obligatory).

⁴ *New England Trust Co. v. Eaton*, 140 Mass. 532; 4 N. E. 69; 54 Am. Rep. 493.

⁵ *Curtis v. Osborn* (Conn.), 65 Atl. 968.

⁶ *Bergen v. Valentine*, 63 How. Pr. (N. Y.) 221; *New York Life, etc. Co. v. Kane*, 17 N. Y. App. Div. 542, 546; 45 N. Y. Supp. 543 (semble); *Shaw v. Cordis*, 143 Mass. 443; 9 N. E. 794.

Cf. *Whittmore v. Beekman*, 2 Dem. (N. Y.) 276; *Reynal v. Thebaud*, 3 N. Y. Misc. 187; 23 N. Y. Supp. 615.

vendor and purchaser, the question whether interest which had accrued but was not yet payable at the time of the sale should go to the buyer or to the seller or should be apportioned, depends entirely upon the intention of the parties as gathered from the contract between them construed in the light of the surrounding circumstances. If any intention, one way or the other, is discoverable, it must prevail. If not, the matter may be governed by any custom of the community in which the transaction takes place.¹

As to coupons which are mature at the time of the sale, the rule ordinarily is that they do not pass to the purchaser, unless they are in default. The rule is of course merely a rule as to the presumed intention of the parties. But the mere fact that overdue but not dishonored coupons were annexed to the bond at the time of the sale would not prevent the vendor from cutting them off and retaining them for himself.

§ 1772. **Whether Coupons deemed Specialties because Bond is under Seal — Statute of Limitations.** — Ordinarily, of course, interest on an obligation is deemed a mere incident of the principal, and partakes of the nature thereof, so that, if the original obligation is under seal, the interest thereon is likewise deemed to arise by virtue of a specialty. Hence, the form of action in a suit to recover such interest must be debt or covenant; and the period of limitations applicable thereto is the period applicable to an action on a sealed instrument. These same rules apply to coupon bonds or debentures.² Hence, an action on an interest coupon cut from a bond or debenture under seal is not barred by limitations until the lapse of the period limited for actions on specialties, although a shorter period is limited for actions on simple contracts and although the coupon itself is not under seal.³ This decision is very close to the line, and comes perilously near being inconsistent with cases holding that

¹ Cf. *Dwight v. Smith*, 13 Fed. *Toronto Gen. Trusts Corp. v. Central Ont. Ry. Co.*, 6 Ont. L. R. 534.

² Cf. *Barry v. Merchants' Exchange Co.*, 1 Sandf. Ch. (N. Y.) 280, 313. As to the form of action, see also *infra*, § 1774. Cf. *Cornwall Minerals Ry. Co.* (1897), 2 Ch. 74. The statute begins to run against each coupon from the maturity thereof and not

³ *City v. Lamson*, 9 Wall. 477; *Philadelphia, etc. R. R. Co. v. Fidelity Ins., etc. Co.*, 105 Pa. St. 216; from the maturity of the bond. See *infra*, § 1791.

each coupon is a separate instrument upon which suit may be maintained independently of the bond or debenture.¹

§ 1773. **Miscellaneous Respects in which Coupon is deemed mere Part or Incident of the Bond.** — A coupon, though detached from the bond, remains so far a part of the original instrument as to be subject to any conditions and qualifying provisions therein contained.² Furthermore, where a statute limits the amount which the corporation may borrow, the amount represented by coupons, being mere interest on the principal sum, is not to be counted in calculating whether the limit has been exceeded.³

§ 1774—§ 1777. *Coupons as separate Instruments.*

§ 1774. **Actions on Detached Coupons.** — But, although the several coupons may for some purposes be deemed mere incidents or accessories of the bond or debenture, yet in other and, as said above, more important aspects, they occupy the position of separate instruments. Hence, in an action on a bond and coupons, the latter are not to be reckoned as representing interest within the meaning of the Act of Congress limiting the jurisdiction of the federal courts to cases in which the amount in controversy “exclusive of interest” exceeds \$2000.⁴ Moreover, an action may be maintained on an overdue detached coupon without profer of the bond and without its production in evidence,⁵ and therefore of course although the plaintiff be not the owner thereof.⁶ The action is maintainable although after the coupon was detached the bond may have been paid

¹ *Infra*, § 1774.

² *McClelland v. Norfolk Southern R. R. Co.*, 110 N. Y. 469; 18 N. E. 237; 6 Am. St. Rep. 397; 1 L. R. A. 299. Cf. *Haskins v. Albany, etc. Ry. Co.*, 74 N. Y. App. Div. 31 (where an intention was discerned to make the coupons transferable free of conditions relating to remedies of the trustee and the bondholders); *Hibbs v. Brown*, 82 N. E. 1108; 190 N. Y. 167.

³ *Durant v. Iowa County*, 1 Woolw. 69, 71.

⁴ *Edwards v. Bates County*, 163 U. S. 269; 16 Sup. Ct. 967.

⁵ *Commissioners of Knox Co. v. Aspinwall*, 21 How. 539, 546; *City v. Lamson*, 9 Wall. 477; *Nat. Exchange Bank v. Hartford, etc. R. R. Co.*, 8 R. I. 375; 91 Am. Dec. 237; 5 Am. Rep. 582.

But see *Crosby v. New London, etc. R. R. Co.*, 26 Conn. 121. *Quære*, is it necessary to prove that the coupon was cut from a duly executed bond? See *Welsh v. First Div. St. Paul, etc. R. R. Co.*, 25 Minn. 314, 318-320.

⁶ *Thompson v. Lee County*, 3 Wall. 327, 332; *City v. Lamson*, 9 Wall. 477.

or cancelled.¹ An action upon a coupon is not converted into a suit on the bond, so as to necessitate proof or production thereof, merely because the declaration may set out the terms of the bond by way of inducement, for the purpose of explaining the relation which the coupon formerly bore thereto.² An action upon the coupon may be maintained under a general count in debt,³ or according to some decisions under a count in assumpsit although the bonds (but not the coupons) are under seal.⁴ A decision in a suit upon one overdue coupon cannot be pleaded as *res judicata* in an action upon another coupon from the same bond between the same parties but is available only by way of estoppel and therefore only in so far as the same questions were actually raised and decided in the former suit.⁵

§ 1775. **Interest on overdue Coupons.** — An interest coupon is deemed so far a separate instrument that it itself bears interest from the date of default thereon although in that way compound interest is allowed on the original bond.⁶ It has been held, however, in New York, that interest will not run upon overdue cou-

¹ *Clark v. Iowa City*, 20 Wall. 583; *Nat. Exchange Bank v. Hartford, etc. R. R. Co.*, 8 R. I. 375; 91 Am. Dec. 237; 5 Am. Rep. 582.

² *City v. Lamson*, 9 Wall. 477. Cf. *Nat. Exchange Bank v. Hartford, etc. R. R. Co.*, 8 R. I. 375 (headnote inadequate); 91 Am. Dec. 237; 5 Am. Rep. 582.

³ *Nat. Exchange Bank v. Hartford, etc. R. R. Co.*, 8 R. I. 375; 91 Am. Dec. 237; 5 Am. Rep. 582.

⁴ *First Nat. Bank v. Bennington*, 16 Blatchf. 53; *Manning v. Norfolk Southern R. Co.*, 29 Fed. 838.

Cf. *Clarke v. City of Janesville*, 1 Biss. 98 — an early case, decided before the modern law of this subject was established, in which the plaintiff sued in assumpsit upon coupons which were still attached to the bonds. See also *supra*, § 1172.

⁵ *Schmidt v. Louisville, etc. Ry. Co.*, 84 S. W. 314; 27 Ky. Law Rep. 21.

⁶ *Aurora City v. West*, 7 Wall. 82, 104-105; *Genoa v. Woodruff*, 92 U. S. 502; *Langston v. S. Car.*

R. R. Co., 2 S. Car. 248; *Connecticut Mut. Life Ins. Co. v. Cleveland, etc. R. R. Co.*, 41 Barb. (N. Y.) 9; *Welsh v. First Division St. Paul, etc. R. R. Co.*, 25 Minn. 314; *Gibert v. Washington City, etc. R. R. Co.*, 33 Gratt. (Va.) 586, 598-599; *Phila., etc. R. R. Co. v. Knight*, 124 Pa. St. 58; 16 Atl. 492; *Whitaker v. Hartford, etc. R. R. Co.*, 8 R. I. 47; 5 Am. Rep. 547; *County of Beaver v. Armstrong*, 44 Pa. St. 63; *Phila., etc. R. R. Co. v. Smith*, 105 Pa. St. 195; *Rice v. Shealey*, 71 S. Car. 161, 169-171; 50 S. E. 868; *Board of Comm'rs of Ouray County v. Geer*, 108 Fed. 478; 47 C. C. A. 450.

Cf. *Corcoran v. Chesapeake, etc. Canal Co.*, 1 MacA. (D. C.) 358 (affirmed on another ground, 94 U. S. 741); *Haven v. Grand Junction, etc. Co.*, 109 Mass. 88, 99 (headnote inadequate); *Humphreys v. Morton*, 100 Ill. 592; *U. S. Mortgage Co. v. Sperry*, 138 U. S. 313; 11 Sup. Ct. 321 (applying the law of Illinois); *Grand Trunk Ry. Co. v. Central Vermont R. Co.*, 105 Fed. 411.

pons if they remain attached to the bond and belong to the same person.¹ But it is submitted that these decisions are unfortunate; for surely the bondholder should have the same rights as an assignee, and ought not to be coerced into transferring the coupons by thus placing a premium on an assignment. Accordingly, the prediction is ventured that this distinction between detached and undetached coupons will not be generally followed.² Although coupons bear interest as against the company, yet where a holder of a prior lien on the company's property has waived his priority in favor of the bonds with interest, his waiver extends only to simple interest on the amount of the bonds and does not cover interest to accrue upon coupons.³

The rate of interest payable on overdue coupons is not necessarily the same rate borne by the bond, but is the rate prescribed by law in lieu of damages for failure to perform an obligation for the payment of money when no particular rate is prescribed by the contract.⁴

The question at what time interest on a coupon commences to run is considered below.⁵

§ 1776. **Whether Guarantee of Principal and Interest of Bond extends to detached Coupons.**—The doctrine that a detached coupon is a separate instrument has been carried by some authorities to great extremes. For instance, where by an endorsement upon a coupon bond a person guaranteed "to the holder of the within bond the punctual payment of principal and interest as the same shall become due and payable," the majority of a New York court held that the guaranty did not enure to the benefit of the holder of a detached coupon, since that was a separate instrument.⁶ It is submitted, however, that this conclusion is

¹ *Williamsburgh Savings Bank v. Town of Solon*, 136 N. Y. 465, 480–482; 32 N. E. 1058; *Buffalo Loan Co. v. Medina Gas Co.*, 12 N. Y. App. Div. 199; 42 N. Y. Supp. 781; *Columbus, etc. R. R. Co. Appeals*, 109 Fed. 177, 193–194; 48 C. C. A. 275 (applying the law of New York as place of performance).

Cf. *Hewel v. Hugin* (Cal.), 84 Pac. 1002.

² *Philadelphia, etc. R. R. Co. v. Smith*, 105 Pa. St. 195.

³ *Commonwealth of Virginia v. State of Md.*, 32 Md. 501, 547–550.

⁴ *Cromwell v. County of Sac*, 96 U. S. 51 (headnote inadequate).

⁵ *Infra*, § 1792.

⁶ *Clokey v. Evansville, etc. R. R. Co.*, 44 N. Y. Supp. 631; 16 N. Y. App. Div. 304. Cf. *Eastern Townships Bank v. St. Johnsbury, etc. R. R. Co.*, 40 Fed. 423.

But see *Connecticut Mutual Life Ins. Co. v. Cleveland, etc. R. R. Co.*, 41 Barb. (N. Y.) 9; *Phila., etc. R. R.*

very narrow and defeats the real intention of the parties, and that the opinion of the dissenting judge contains the preferable reasoning.

§ 1777. **Detached Coupons covered by Bequest of "Bonds."** — Under a bequest of all the testator's bonds, detached coupons will pass.¹ This decision went upon the ground that the detached coupons are virtually separate bonds; but if the coupons were detached from bonds belonging to the testator, the same result might have been reached upon the ground that the coupons would pass as incidents of the bonds.

§ 1778. **Negotiability of detached Coupons.** — Moreover, each coupon when detached from the bond not merely becomes a separate instrument; but if it is payable to bearer — and at least in America most interest coupons are so drawn — it becomes a negotiable instrument transferable by delivery.² But where the coupon is not expressed to be payable to bearer or order, it is perhaps not negotiable although the bond from which it was detached may have been so payable.³ The presumption is that the holder of a negotiable coupon took in ordinary course before dishonor.⁴ Moreover, where the bonds and coupons are guaranteed by another corporation which has power under its charter to make such a contract, the coupons

Co. v. Knight, 124 Pa. St. 58; 16 Atl. 492.

¹ *Sanborn v. Clough*, 64 N. H. 315; 10 Atl. 678.

² *Thompson v. Perrine*, 106 U. S. 589; 1 Sup. Ct. 564, 568; *Tyrrell v. Cairo, etc. R. R. Co.*, 7 Mo. App. 294; *Town of Eagle v. Kohn*, 84 Ill. 292 (semble); *Haven v. Grand Junction, etc. Co.*, 109 Mass. 88; *Evertson v. Nat. Bank of Newport*, 66 N. Y. 14; 23 Am. Rep. 9; *Nat. Exchange Bank v. Hartford, etc. R. R. Co.*, 8 R. I. 375; 91 Am. Dec. 237; 5 Am. Rep. 582; *County of Beaver v. Armstrong*, 44 Pa. St. 63.

Cf. *Meyers v. New York, etc. R. R. Co.*, 43 Me. 232; *Jackson v.*

Y. & C. R. R. Co., 48 Me. 147; *McClelland v. Norfolk Southern R. R. Co.*, 110 N. Y. 469; 18 N. E. 237; 6 Am. St. Rep. 397; 1 L. R. A. 299.

See also *Clarke v. City of Janesville*, 1 Biss. 98.

³ *Evertson v. Nat. Bank of Newport*, 66 N. Y. 14; 23 Am. Rep. 9; *Wright v. Ohio, etc. R. R. Co.*, 1 Disney (Oh.) 465; *Augusta Bank v. Augusta*, 49 Me. 507.

But see *Smith v. County of Clark*, 54 Mo. 58; *Philadelphia, etc. R. R. Co. v. Smith*, 105 Pa. St. 195 (headnote inadequate); *McCoy v. Washington County*, 3 Wall. Jr. C. C. 381.

⁴ *Ketchum v. Duncan*, 96 U. S.

are negotiable against the guarantor as well as against the principal obligor.¹

§ 1779. *Coupons distinguished from Bank Notes.* — Although coupons are negotiable, yet they are neither intended nor adapted to pass from hand to hand as currency, and hence they are not prohibited by statutes forbidding corporations to issue bank notes.²

§ 1780—§ 1781. *Relative Rights of Holder of detached Coupon and Holder of Bond.*

§ 1780. **In general.** — A transfer of a coupon does not import a warranty of payment³ any more than the delivery of a bill of exchange payable to bearer would do. Hence, the transferee gets ordinarily no right to have the coupon paid in preference to the principal of the bond from which it was cut or to subsequently accruing coupons. To be sure, bonds or debentures, or the covering deed of trust, sometimes provide that moneys realized from the security shall be applied, first in payment of unpaid interest, and second in paying the principal obligation;⁴ but in the absence of such a provision, bond and coupon, although the latter has been detached and sold, rank *pari passu*.⁵

¹ *Connecticut Mutual Life Ins. Co. v. Cleveland, etc. R. R. Co.*, 41 Barb. (N. Y.) 9. Cf. *supra*, § 1755.

But see *Clokey v. Evansville, etc. R. R. Co.*, 44 N. Y. Supp. 631; 16 N. Y. App. Div. 304 (criticised, *supra*, § 1776); *Eastern Townships Bank v. St. Johnsbury, etc. R. R. Co.*, 40 Fed. 423.

² *Barry v. Merchants' Exchange Co.*, 1 Sandf. Ch. (N. Y.) 280, 313–314.

³ *Ketchum v. Duncan*, 96 U. S. 659, 660.

⁴ Cf. *Morton Trust Co. v. Home Tel. Co.*, 57 Atl. 1020; 66 N. J. Eq. 106; *Low v. Blackford*, 87 Fed. 392, 394–396; 31 C. C. A. 15 (where a provision in the deed of trust giving priority to overdue coupons was enforced although not found in the bonds themselves); *Louisville, etc. R. R. Co. v. Schmidt*, 52 S. W. 835; 21 Ky. Law Rep. 556 (holding that

in such a case bonds and coupons are not secured by one lien within the meaning of a statute providing that where several debts are secured “by one lien or by liens of equal rank” there shall be no sale until all the debts are due). Even under such a provision, coupons maturing after a decree of foreclosure are entitled to no preference over but rank *pari passu* with the principal of the bonds. *Burke v. Short*, 79 Fed. 6; 24 C. C. A. 422.

⁵ *Ketchum v. Duncan*, 96 U. S. 659, 670–671; *Dunham v. Cincinnati, etc. Ry. Co.*, 1 Wall. 254; *Humphreys v. Morton*, 100 Ill. 592; *Miller v. Rutland, etc. R. R. Co.*, 40 Vt. 399; 94 Am. Dec. 413; *State v. Spartansburg, etc. R. R. Co.*, 8 S. Car. 129; *Clews & Co. v. First Mortgage Bondholders*, 51 Ga. 131, 133 (head-note inadequate); *Real Estate Trust Co. v. Union Trust Co.*, 102 Md. 41,

A provision that in case the trustee enters into possession for default in non-payment of interest coupons, the coupons so overdue shall have priority does not by implication give any priority to overdue coupons in case of any ordinary foreclosure.¹ If, however, the owner of substantially all the shares and bonds of a corporation for purpose of assisting in "unloading" the bonds upon the market cuts off and secretly retains in his possession the overdue coupons, he cannot subsequently bring them forward as basis for a claim to share *pro rata* with the purchasers of the bonds, to whom he had virtually represented that the overdue coupons had been paid;² but if in such a case the transferee is the bank which is charged with the duty of paying the coupons and which therefore knows that the coupons have not been paid, the rule is different.³ As all the coupons rank *pari passu* with the bonds they also rank *pari passu* with one another irrespective of the dates of their maturity.⁴ Even where some coupons maturing on a certain date have been paid in full by the company, others maturing at the same time are entitled to no priority over coupons subsequently maturing.⁵ Where a sale is made for default in interest, the principal not being yet payable, the proceeds of sale must *ex necessitate rei* be applied first, if not exclusively, to payment of the arrears of interest.⁶

52-53; 61 Atl. 228 (as to interest on scrip certificates convertible into bonds).

Cf. *Child v. New York, etc. R. R. Co.*, 129 Mass. 170, 174; *Sewell v. Brainerd*, 38 Vt. 364; *Hollister v. Stewart*, 111 N. Y. 644; 19 N. E. 782.

In a few cases, however, it has been held that unpaid detached coupons have priority over coupons subsequently accruing and over the bonds themselves. *Stevens v. New York, etc. R. R. Co.*, 13 Blatchf. 412. Cf. *Grand Trunk Ry. Co. v. Central Vermont R. Co.*, 105 Fed. 411 (where money set apart to pay one set of coupons was used in paying subsequent coupons, holders of unpaid coupons of the first set held entitled to priority).

¹ *M'Tighe v. Keystone Coal Co.*, 99 Fed. 134; 39 C. C. A. 447.

² *Wood v. Guarantee Trust Co.*, 128 U. S. 416, 424-426; 9 Sup. Ct. 131. Cf. *Farmers' L. & T. Co. v. Oregon, etc. R. R. Co.*, 67 Fed. 404.

³ *Rhawn v. Edge Hill Furnace Co.*, 201 Pa. St. 637; 51 Atl. 360.

⁴ *Humphreys v. Morton*, 100 Ill. 592.

But see *Stevens v. New York, etc. R. R. Co.*, 13 Blatchf. 412.

⁵ *M'Tighe v. Keystone Coal Co.*, 99 Fed. 134; 39 C. C. A. 447.

⁶ *Ohio Central R. R. Co. v. Central Trust Co.*, 133 U. S. 83; 10 Sup. Ct. 235. See *infra*, § 1804.

But see *State v. Spartansburg, etc. R. R. Co.*, 8 S. Car. 129.

§ 1781. **Waiver by Holder of both Bonds and Coupons of Preference carried by the Coupons, in order to escape Income tax.** — Even where the covering deed of trust provides for payment of arrears of interest before payment of the principal, nevertheless if the company is insolvent and therefore looks upon the matter of apportionment between principal and interest with indifference, and if both the bonds or debentures and the overdue interest warrants are owned by the same persons, the court in distributing the proceeds of the security may order that the amounts distributed be deemed to be paid on account of principal, where such a direction is favorable to the holders of the bonds and interest-warrants by enabling them to escape paying an income tax on the amounts so distributed.¹ Indeed, when the orders of court by which the payments are directed leave the question open whether the payments shall be taken to have been made on account of principal or interest, the court may, where the company is insolvent and both bonds and coupons are owned by the same persons, direct by a subsequent order that the payments be taken to have been made on account of principal so as to enable the bondholders to escape payment of the income tax.² The provision in the trust deed for paying the interest before the principal is deemed to confer a privilege on the persons who are entitled to payment of the interest — a privilege which they may waive.

§ 1782–§ 1786. *Whether Transfer of Coupon is Sale or Payment.*

§ 1782. **In general.** — Of course, if a coupon is not sold but paid, it is cancelled and discharged, and cannot subsequently be made the basis of a claim to share in the mortgage or the proceeds thereof in competition with the holders of unpaid bonds or coupons. Hence, whenever a coupon is transferred from one person to another, the transferee's interest is to show that the transfer was intended as a sale, for in that case he is entitled to the security of the mortgage *pari passu* with the holders of the bonds and of the other coupons; but the interest of the bondholders and other coupon holders, including the transferor if he

¹ *Smith v. Law Guarantee, etc. Society* (1904), 2 Ch. 569. ² *Smith v. Law Guarantee, etc. Society* (1904), 2 Ch. 569.

remains the owner of bonds or other coupons, is to establish that payment was intended, and thus to reduce the amount secured by the mortgage. Whether the transaction be intended as a sale or as a payment is in each case a question of fact and not of law.¹ Of course, where the company uses borrowed money in paying coupons, the lender is not subrogated to the rights of the coupon holders.²

§ 1783. **Presumptions.** — It is said that where “a sale, compared with payment, is prejudicial to the holder’s interest, by continuing the burden of the coupons upon the common security, and lessening its value in reference to the principal debt, the intent to sell should be clearly proved”;³ but it would certainly seem that any transfer to a person other than the corporation is *prima facie* a sale, and that he who alleges the transaction to amount to payment should have the burden of showing that both parties contemplated payment rather than sale. Of course, however, if the transfer is made to the company or to one who was either actually or apparently acting as its agent, the case is changed, and the transaction becomes *prima facie* a payment.

§ 1784. **Examples.** — For instance, if when the coupons are presented at the company’s office for payment, a cheque drawn by the company’s bankers and fiscal agents is given in exchange therefor, the transaction will be held to be a payment and not a sale to the bankers, whatever the latter’s intention, undisclosed to the coupon holders, may have been;⁴ and it makes no difference that the coupons by their terms were payable not at the corporation’s office, where the transaction took place, but at the office of a certain trust company.⁵ Very clearly, if coupons are

¹ *Wood v. Guarantee Trust Co.*, 128 U. S. 416; 9 Sup. Ct. 131; *Morton Trust Co. v. Home Tel. Co.*, 57 Atl. 1020; 66 N. J. Eq. 106.

² *Newport, etc. Bridge Co. v. Douglas*, 12 Bush (Ky.) 673; *Contracting, etc. Bldg. Co. v. Continental Trust Co.*, 108 Fed. 1; 47 C. C. A. 143; *Illinois Trust, etc. Co. v. Doud*, 105 Fed. 123; 44 C. C. A. 389; 52 L. R. A. 481; *Commonwealth of Virginia v. State of Md.*, 32 Md. 501, 540-547.

Cf. *Wrexham, etc. Ry. Co.* (1899), 1 Ch. 440.

But see *Newbold v. Peoria, etc. R. R. Co.*, 5 Ill. App. 367.

³ *Ketchum v. Duncan*, 96 U. S. 659, 662.

Cf. *Venner v. Farmers’ L. & T. Co.*, 90 Fed. 348; 33 C. C. A. 95.

⁴ *Baker v. Meloy*, 95 Md. 1; 51 Atl. 893.

⁵ *Baker v. Meloy*, 95 Md. 1, 14 (headnote inadequate); 51 Atl. 893.

But cf. *Ketchum v. Duncan*, 96 U. S. 659, 663.

surrendered for cash at the office of the company or other place where by their terms they are payable, the transaction cannot be converted into a sale by any secret arrangement, unknown to the coupon holders, by which the coupons were to be kept alive for the benefit of the person who advanced the necessary cash.¹ Moreover, where a company paid to its fiscal agents sufficient funds to pay accruing interest on its first-mortgage bonds, but the agents diverted the funds to payment of subsequent liens, the court held that the agents upon acquiring the first-mortgage coupons which ought to have been paid off would not be allowed to hold such coupons as outstanding debts covered by the mortgage lien to the prejudice of bondholders, but that in the hands of the agent the coupons should be treated as paid and discharged.² On the other hand, where, upon presentation of the coupons to the obligor company for payment, the holders were told to take them to a certain bank, which, acting on behalf of D. S. & Co., gave cash for them, the court held that the transaction was a sale, the evidence being explicit, that D. S. & Co. *intended* to purchase and not to pay the coupons.³

The fact that the person taking up the coupons owns substantially all the company's shares is a circumstance tending to prove payment rather than sale, and when supplemented by the fact that coupons after being taken up were punctured and

¹ *Fidelity, etc. Co. v. West Pa., etc. Co.*, 138 Pa. St. 494; 21 Atl. 21; 21 Am. St. Rep. 911; *Union Trust Co. v. Monticello, etc. Ry. Co.*, 63 N. Y. 311; 20 Am. Rep. 541; *Cameron v. Tome*, 64 Md. 507; 2 Atl. 837; *Farmers' L. & T. Co. v. Iowa Water Co.*, 78 Fed. 881; *South Covington, etc. Ry. Co. v. Gest*, 34 Fed. 628; *Morton Trust Co. v. Home Tel. Co.*, 57 Atl. 1020; 66 N. J. Eq. 106.

But see *Hand v. Savannah, etc. R. Co.*, 17 S. Car. 219, 260-266. Cf. *Hollister v. Stewart*, 111 N. Y. 644; 19 N. E. 782.

Such an arrangement is, however, effective against everybody except the holders of the bonds and other coupons, and hence the person who advanced the money is entitled to share in any balance of the sum realized from the mortgage

that may remain after payment of the other coupons and bonds. *Haven v. Grand Junction, etc. Co.*, 109 Mass. 88. Cf. *Miller v. Rutland, etc. R. R. Co.*, 40 Vt. 399, 407-409; 94 Am. Dec. 413; *Union Trust Co. v. Monticello, etc. Ry. Co.*, 63 N. Y. 311; 20 Am. Rep. 541; *Cameron v. Tome*, 64 Md. 507; 2 Atl. 837.

² *Farmers' L. & T. Co. v. New England Waterworks Co.*, 137 Fed. 729; 70 C. C. A. 163.

³ *Ketchum v. Duncan*, 96 U. S. 659. Cf. *Clafin v. South Carolina R. R. Co.*, 8 Fed. 118, 134-138 (headnote inadequate).

But see *Morton Trust Co. v. Home Tel. Co.*, 57 Atl. 1020; 66 N. J. Eq. 106; *Commonwealth of Virginia v. State of Md.*, 32 Md. 501, 540-547.

defaced, some being marked "paid," completely disproves a sale.¹

§ 1785. **Rights of Guarantor on taking up Coupons.** — If coupons are paid by a corporation which is liable upon them as guarantor, they cannot be availed of in competition with the holders of the bonds and other coupons so as to diminish their security;² but doubtless as against other creditors of the company the guarantor would be subrogated to the security enjoyed by the coupon holder.³ Where, however, by endorsement on the bonds another company agrees to "purchase" the coupons if they are not paid at maturity, it would seem that the latter company on taking up overdue coupons should be treated in all respects as a purchaser thereof.⁴

§ 1786. **Surrender of Coupons in pursuance of a Funding Scheme.** — Where coupons are not paid but exchanged for certificates of indebtedness in pursuance of a funding plan, the circumstances may be such as to warrant the conclusion that the lien of the original coupons was intended to be kept alive for the benefit of the certificate holders, and that intent if proved may be effectuated.⁵ But ordinarily, in such a case of exchange, especially where the coupons are surrendered and cancelled, the courts will infer that the new security is accepted in discharge of the lien.⁶

§ 1787. **Coupons due before Issue of Bond — Rights of Underwriter.** — If a bond is not issued until some of the coupons are overdue, these if cut off and retained by the company cannot subsequently be galvanized into vitality by their issue or sale, so as to compete with the other coupons and the bonds.⁷ Where

¹ *Wood v. Guarantee Trust Co.*, 128 U. S. 416, 424 (headnote inadequate); 9 Sup. Ct. 131.

Cf. *South Covington, etc. Ry. Co. v. Gest*, 34 Fed. 628.

² *Child v. New York, etc. R. R. Co.*, 129 Mass. 170, 175-177; *Columbia, etc. Trust Co. v. Kentucky Union Ry. Co.*, 60 Fed. 794; 9 C. C. A. 264. Cf. *Commonwealth of Virginia v. State of Md.*, 32 Md. 501, 539-540.

³ *Commonwealth of Virginia v. State of Md.*, 32 Md. 501.

⁴ *Pennsylvania R. R. Co. v. Allegheny, etc. R. R. Co.*, 48 Fed. 139.

⁵ *Gibbes v. G. & C. R. R. Co.*, 13 S. Car. 228.

⁶ *Fidelity Ins., etc. Co. v. Shenandoah Valley R. R. Co.*, 86 Va. 1, 12-15; 9 S. E. 759; 19 Am. St. Rep. 858.

⁷ Cf. *Wood v. Guarantee Trust Co.*, 128 U. S. 416, 425; 9 Sup. Ct. 131.

an underwriting agreement provides that the bonds underwritten shall be pledged to secure a debt contracted by another corporation and that the underwriters upon being called upon to perform their agreement and upon making payment accordingly shall be entitled to receive their respective proportion of the bonds from the pledgee, then, in the absence of a provision that the bonds shall not be deemed to be issued until delivered to the underwriters, any coupons which may mature after the execution of the underwriting agreement and while the bonds are still in the possession of the pledgee will belong to the underwriters as soon as they make payment in accordance with their underwriting agreement, even though the coupons may have been detached (but not collected) by the pledgee.¹

§ 1788-§ 1796. MATURITY OF COUPONS.

§ 1788. **Mode of Payment — Money, Scrip, etc.** — Usually, coupons are payable in money. Where in a certain contingency the company has an option to pay the interest in scrip, it must exercise the option strictly by the day on which the interest falls due, otherwise payment must be made in money.² The holders of overdue coupons may of course voluntarily accept other obligations of the company in lieu of cash; but no coupon holder can be forced to accept any such funding agreement. Where the coupons are funded, interest-bearing receipts being given in exchange, the latter instruments are intended to be freely transferable and partake to such an extent of the nature of negotiable paper that the company will be estopped from questioning the right of any *bona fide* transferee thereof even though the coupons for which they purport to have been exchanged were never surrendered.³

§ 1789. **Coupons payable at a particular Place.** — If coupons by their terms are payable at a particular place, demand should be made there, except under extraordinary circumstances, before bringing suit.⁴ Conversely, it seems that the company in order to

¹ *Hudson Valley Ry. Co. v. Western Md. R. R. Co. v. Frank-O'Connor*, 95 N. Y. App. Div. 6; *lin Bank*, 60 Md. 36.

88 N. Y. Supp. 742.

² *Texas, etc. Ry. Co. v. Marlbor*, period from which interest runs) 123 U. S. 687; 8 Sup. Ct. 311. Cf. and § 1794 (as to whether principal has become due).

establish a complete defence upon the ground that no demand for payment was made upon it must show readiness and willingness to pay at the place appointed for payment.¹

§ 1790-§ 1796. *When Coupons to be deemed overdue.*

§ 1790. **Classes of Cases in which the Question may arise.** — The question when a coupon is to be deemed overdue may arise in four distinct cases which are controlled by different considerations. First, cases where the point is as to the date from which the statutory period of limitations is to be calculated. Second, cases where the contention is as to the date from which interest should be reckoned. Third, cases in which it is claimed that at the time of a transfer the coupons were so far overdue as to preclude the transferee from occupying the position of a *bona fide* purchaser for value. Fourth, cases in which the question is whether a default has been committed in payment of interest so as to justify foreclosure proceedings or the like, or so as to accelerate the maturity of the principal under a clause providing that the principal shall become immediately due upon default for a certain length of time in the payment of interest.

§ 1791. **For Purpose of Statute of Limitations.** — For the purpose of the statute of limitations, a coupon is overdue at once upon its maturity, so that the statute begins to run immediately without demand or presentation of the coupon. It is true that ordinarily the period of limitations does not commence to run against a claim for interest until the principal falls due; and if the nature of coupons as representing interest on the bonds were allowed to prevail, the statute would not begin running against the coupons until the maturity of the bond. But, as already stated, this view has not been taken by the courts. For purposes of limitations, each coupon when detached from the bond is deemed a separate instrument upon which the statute runs from the date of its own maturity;² and this defence of limitations cannot be avoided by attempting to recover the overdue and outlawed coupons in a suit on the bond for the principal debt.³

¹ *Philadelphia, etc. R. R. Co. v. Johnson*, 54 Pa. St. 127.

² *Clark v. Iowa City*, 20 Wall. 583.

Cf. *North Pa. R. R. Co. v. Adams*, 54 Pa. St. 94; 93 Am. Dec. 677.

³ *Griffin v. Macon County*, 36 Fed. 885; 2 L. R. A. 353.

This is more noteworthy, because the coupons so far share the nature of a bond that if the latter is under seal while the former is not, the statutory period applicable to the coupons is that which applies to contracts under seal.¹

§ 1792. **For Purpose of calculating Interest.** — We have seen that interest-coupons are deemed so far separate instruments as to bear interest from the date of default in respect of them, although in that way compound interest is allowed on the original bond.² The question remains from what point of time the interest on the coupons should be calculated. Since such coupons are intended for immediate presentation and payment, it would seem on principle that, unless under exceptional circumstances, interest should not begin to run until the coupons are duly presented for payment.³ Nevertheless, in a number of cases, interest has been allowed from the very maturity of the coupon, unless the corporation's willingness and ability to pay at maturity affirmatively appeared by way of defence;⁴ but in some at least of these cases it does not appear but that due demand was made at maturity.

§ 1793. **For purpose of charging Transferee with constructive Notice of Defences.** — The law seems settled that a transferee of an overdue and dishonored coupon succeeds to no greater rights than his transferor, but on the contrary takes subject to all equities and defences available between prior parties.⁵ The

¹ Supra, § 1772.

² Supra, § 1775.

³ *Corcoran v. Chesapeake, etc. Canal Co.*, 1 MacA. (D. C.) 358 (affirmed on another ground, 94 U. S. 741); *Whitaker v. Hartford, etc. R. R. Co.*, 8 R. I. 47; 5 Am. Rep. 547.

Cf. *Phelps v. Town of Lewiston*, 15 Blatchf. 131; *County of Beaver v. Armstrong*, 44 Pa. St. 63; *North Pa. R. R. Co. v. Adams*, 54 Pa. St. 94; 93 Am. Dec. 677; *Philadelphia, etc. R. R. Co. v. Smith*, 105 Pa. St. 195; *Abraham v. New Orleans Brewing Ass'n*, 110 La. 1012; 35 So. 268 (where the company was always ready and willing to pay the coupons if presented); *Grand Trunk Ry. Co. v. Central Vermont R. Co.*, 105 Fed. 411.

⁴ *Walnut v. Wade*, 103 U. S.

683, 696 (headnote inadequate); *Aurora City v. West*, 7 Wall. 82, 104-105 (headnote inadequate); *Genoa v. Woodruff*, 92 U. S. 502; *Cromwell v. County of Sac*, 96 U. S. 51, 62; *Humphreys v. Morton*, 100 Ill. 592; *Langston v. S. Car. R. R. Co.*, 2 S. Car. 248; *Welsh v. First Division St. Paul, etc. R. R. Co.*, 25 Minn. 314; *Gibert v. Washington City, etc. R. R. Co.*, 33 Gratt. (Va.) 586, 598-599; *Phila., etc. R. R. Co. v. Knight*, 124 Pa. St. 58; 16 Atl. 492; *Abraham v. New Orleans Brewing Ass'n*, 110 La. 1012; 35 So. 268 (semble); *Hughes County v. Livingston*, 104 Fed. 306; 43 C. C. A. 541.

See also 2 Daniel on Neg. Instr. (5th ed.), § 1514-§ 1515.

⁵ *Holden's Case*, 8 Eq. 444, 449;

decided cases do not, however, show with clearness at what point of time a coupon is to be taken to have become overdue for the purposes of this rule. It is submitted that the same doctrine should be applied as in the case of an ordinary bank cheque. That is to say, the coupon should be deemed overdue and dishonored after but not before the lapse of a reasonable time from its maturity,¹ the question what is such a reasonable time being a question to be decided on the facts of each case.

§ 1794. **For Purpose of determining whether such a Default has occurred as under the Terms of the Bonds will cause the Principal to become immediately due.** — Bonds or debentures sometimes provide that if default in payment of interest shall be made and continue for some specified time, then the principal sum shall become immediately due, or may be declared due by the trustee of the mortgage.² In order to put the company in default so as to justify the application of such a provision, the coupon must be actually presented and demand made:³ it is not enough that the company may be notoriously unable or unwilling to comply with a demand if duly made.⁴ Moreover, if a place for payment is named, there is ordinarily no sufficient default unless demand

Wood v. Guarantee Trust Co., 128 U. S. 416, 426; 9 Sup. Ct. 131; *Gilbough v. Norfolk, etc. R. R. Co.*, 1 Hughes 410; *Child v. New York, etc. R. R. Co.*, 129 Mass. 170, 174-175; *McKim v. King*, 58 Md. 502; 42 Am. Rep. 340; *Arents v. Commonwealth*, 18 Gratt. (Va.) 750. Cf. *Baker v. Meloy*, 95 Md. 1, 7-8; 51 Atl. 893 (where the point was conceded by counsel); and *supra*, § 1753.

But see *Grand Rapids, etc. R. R. Co. v. Sanders*, 54 How. Pr. (N. Y.) 214.

It has even been held that a corporation which *pays* overdue coupons does so at its peril, and is liable to the true owner if the coupons turn out to have been stolen — a conclusion difficult to support, since the presentation of overdue coupons for payment is not suspicious but on the contrary most

natural. *Bainbridge v. City of Louisville*, 83 Ky. 285; 4 Am. St. Rep. 153. Cf. *Hinckley v. Union Pacific R. R. Co.*, 129 Mass. 52, 60-61; 37 Am. Rep. 297.

¹ But see *First Nat. Bank v. County Comm'rs of Scott Co.*, 14 Minn. 77; 100 Am. Dec. 194; *Evertson v. Nat. Bank of Newport*, 66 N. Y. 14; 23 Am. Rep. 9.

² See *infra*, § 1804-§ 1812.

³ *Potomac Mfg. Co. v. Evans*, 84 Va. 717; 6 S. E. 2.

⁴ *Chicago, etc. R. R. Co. v. Fosdick*, 106 U. S. 47, 73 et seq. (head-note inadequate); 1 Sup. Ct. 10 (cf. also the dissenting opinion of Waite, C. J., 106 U. S. 79).

But see *Warner v. Rising Fawn Iron Co.*, 3 Woods 514. As to what amounts to a demand, see *Pennsylvania Co. v. Philadelphia, etc. R. R. Co.*, 36 Wkly. Notes Cas. (Pa.) 534.

is there made.¹ If the company is ready to pay at the accustomed place for payment, although not the place named in the bond, and if the fact of such readiness is known to the holder, the latter cannot insist that a default has occurred sufficient to cause the principal to become due unless he seasonably signified his intention to demand payment at the place stipulated in the bond.² If the company proposes a scheme for funding the maturing coupons, which is to be revocable by those who assent thereto unless a majority of the bondholders accept the same, the period of default for the purposes of a provision that the principal shall become due on default for a certain length of time in payment of interest is to be calculated from the date of rescission of the arrangement for lack of the requisite assent by the majority and not from the original refusal to honor the coupons when presented at maturity;³ and this is true although other coupons, which to be sure were never formally presented for payment, were never funded and were never paid.⁴ Even if coupons are subject to days of grace, which is to say the least doubtful,⁵ the period of default within the meaning of a provision accelerating maturity of the principal for default for a specified period in payment of interest begins to run from the date of maturity of the coupon and not from the expiration of the last day of grace.⁶

§ 1795. **For Purpose of determining whether Foreclosure Proceedings may be instituted.**—The question whether a default in payment of interest has occurred so as to justify the institution of foreclosure proceedings is in general identical with the question whether a default has occurred within the meaning of provisions accelerating the payment of principal. A mere statement by or on behalf of bondholders that until a certain date they will not insist on payment of more than one half the promised interest does not amount to a binding contract or

¹ *Thorn v. City Rice Mills*, 40 *dick*, 106 U. S. 47; 1 Sup. Ct. 10. *See also infra*, § 1808, as to waiver of default in payment of interest coupons.

But see *Warner v. Rising Fawn Iron Co.*, 3 Woods 514; *Savannah, etc. R. R. Co. v. Lancaster*, 62 Ala. 555, 564. Cf. *supra*, § 1789.

² *Union Mutual Life Ins. Co. v. Union Mills Plaster Co.*, 37 Fed. 286; 3 L. R. A. 90.

³ *Chicago, etc. R. R. Co. v. Fos-*

⁴ *Chicago, etc. R. R. Co. v. Fostick*, 106 U. S. 47; 1 Sup. Ct. 10.

⁵ *Infra*, § 1796.

⁶ *Alabama, etc. Mfg. Co. v. Robinson*, 56 Fed. 690; 6 C. C. A. 79.

create an estoppel, so as to prevent the bondholders from revoking the concession on reasonable notice to the company and commencing proceedings for foreclosure unless the full stipulated interest be paid.¹

§ 1796. **Days of Grace.** — Interest coupons, like the bonds themselves, are payable without days of grace.²

§ 1797. **Whether Contract to pay Bonds includes contract to Pay Coupons.** — A contract to assume payment of certain bonds at maturity imports a promise to pay the interest as well as the principal but only when the principal shall have become due; and not semi-annually as the interest accrues.³

§ 1798. **Lost Coupons — Rights of Owners.** — If a coupon is lost the holder has the same remedies as the owner of any other lost negotiable instrument. That is to say, upon tendering a proper bond of indemnity, he may demand payment,⁴ and if the company refuses, he is entitled to interest from that time onward.⁵ Or if the company after receiving notice of the loss pays to one who is not a *bona fide* holder for value, it is liable over again to the lawful owner.⁶

§ 1799-§ 1825. — MATURITY AND PAYMENT OF PRINCIPAL.

§ 1799. **Distinction between Payability and Redeemability.** — A distinction is to be noted between the time when a bond or debenture is redeemable and the time when it is payable: it is redeemable when the company may pay, it is payable when the company must pay.⁷

¹ *Union Trust Co. v. St. Louis, Co.*, 129 Mass. 52; 37 Am. Rep. etc. Ry. Co., 5 Dillon 1. 297.

² *Chaffee v. Middlesex R. R. Co.*, 146 Mass. 224; 16 N. E. 34.

⁵ *Fitchett v. North Pa. R. R. Co.*, 5 Phila. 132.

But see *Evertson v. Bank of Newport*, 66 N. Y. 14; 23 Am. Rep. 9. As to whether the bonds themselves are subject to days of grace, see *infra*, § 1802.

⁶ *Hinckley v. Union Pac. R. R. Co.*, 129 Mass. 52; 37 Am. Rep. 297; *Bainbridge v. City of Louisville*, 83 Ky. 285; 4 Am. St. Rep. 153.

³ *U. S. v. Union Pac. R. R. Co.*, 91 U. S. 72. Cf. *supra*, § 1776.

⁷ *Chicago, etc. Granaries Co.* (1898), 1 Ch. 263.

⁴ *Hinckley v. Union Pac. R. R.*

§ 1800-§ 1814. *AT WHAT TIME THE PRINCIPAL IS PAYABLE.*

§ 1800. **Irredeemable Bonds or Debentures — No Time fixed for Payment.** — The ultimate payment of the principal of bonds or debentures is always contemplated in any ordinary instruments of that class, although the period of payment or maturity is sometimes fixed in the remote future. As an English judge has said, "where a person lends his money, if he is not ever to have his principal paid back, you must have something very definite and clear, showing that this is a condition of the contract."¹ Indeed, it is more than doubtful whether a corporation has power without express authority to issue irredeemable or perpetual bonds.² Hence, when no time for payment of the principal is specified in debentures, they are payable at the latest a reasonable time after demand.³

§ 1801. **Effect of Statute forbidding long-term Bonds.** — A statute authorizing the issue of bonds "payable at such times not to exceed thirty years" as may be determined does not prohibit bonds which are payable within thirty years after they begin to bear interest but not within thirty years after their date.⁴

§ 1802. **Days of Grace.** — The obligor in a corporation bond is not entitled to days of grace.⁵

§ 1803. **Effect of Accumulation of Sinking-Fund sufficient for Payment.** — A stipulation in the bonds or debentures providing for a sinking fund for their ultimate payment does not have the effect of making the bonds redeemable as soon as a sum sufficient to pay them off has been accumulated.⁶

¹ *Hopkins v. Worcester, etc. Canal Proprietors*, 6 Eq. 437.

⁵ *Chaffee v. Middlesex R. R. Co.*, 146 Mass. 224; 16 N. E. 34.

² See *supra*, § 74. But now in England, see *Companies Act, 1907*, § 14.

But see *Evertson v. Nat. Bank of Newport*, 66 N. Y. 14; 23 Am. Rep. 9. As to coupons, see *supra*, § 1796.

³ *Hopkins v. Worcester, etc. Canal Proprietors*, 6 Eq. 437.

⁶ See *infra*, § 1816.

⁴ *City of South St. Paul v. Lamprecht Bros. Co.*, 88 Fed. 449; 31 C. C. A. 585.

§ 1804-§ 1812. ACCELERATION OF MATURITY OF PRINCIPAL
BY DEFAULT IN PAYMENT OF INTEREST. •

§ 1804. **Rights of Parties in Absence of express Provision for Acceleration**—*Effect of Foreclosure Sale for Non-Payment of Interest.*—The question in respect to the payment of bonds or debentures which most frequently arises is whether a default in payment of interest has caused the principal to become immediately due. In the absence of any provision on the subject in the bonds or in the covering deed of trust, the mere fact that interest is in arrears does not render the principal payable presently;¹ and if in such a case a sale is had by way of enforcing the security, while any surplus remaining after payment of the costs and of the overdue interest is properly credited in reduction of the principal of the bonds, the court has no power to declare the balance of the principal due, and enter a decree therefor.² However, where the mortgage deed of trust provided that in case of sale or other proceedings to coerce payment of interest or principal, all bonds and the interest accrued thereon should be entitled to a *pro rata* dividend, but with a proviso that no bond should be considered due until twenty years from the date thereof (that being the term which the bonds on their face were to run), the court held that the proviso was intended merely to exclude the inference that an action might be brought before the lapse of the twenty years, and that therefore the proceeds of a sale which was made for default in interest should be distributed *pro rata* among the holders of the bonds and the overdue coupons, no preference being given to the coupons.³ The fact that the bonds provide that in case of the exercise of

¹ *Chicago, etc. R. R. Co. v. Fosdick*, 106 U. S. 47; 1 Sup. Ct. 10; *Grape Creek Coal Co.*, 65 Fed. 717; 13 C. C. A. 87.

Union Trust Co. v. Missouri, etc. Ry. Co., 26 Fed. 485; *Union Trust Co. v. St. Louis, etc. Ry. Co.*, 5 Dill. 1; *Farmers' L. & T. Co. v. Grape Creek Coal Co.*, 65 Fed. 717; 13 C. C. A. 87; *Dame v. Crochiti, etc. Imp. Co. (N. Mex.)*, 79 Pac. 296, 299 (headnote inadequate).

² *Ohio Central R. R. Co. v. Central Trust Co.*, 133 U. S. 83; 10 Sup. Ct. 235; *Farmers' L. & T. Co. v. Grape Creek Coal Co. v. Farmers' L. & T. Co.*, 63 Fed. 891; 12 C. C. A. 350.

³ *Dunham v. Cincinnati, etc. Ry. Co.*, 1 Wall. 254.

a power of sale for non-payment of interest the proceeds of sale shall after payment of the overdue interest be applied to payment of the principal does not make the whole debt due before the stipulated date of maturity.¹

§ 1805—§ 1812. *Express Provisions for Acceleration.*

§ 1805. **In general.** — Unequivocal provisions for acceleration of the time for payment of the principal in case of a prolonged default in payment of interest, are, however, very common; but being, it is said, penal in nature, they should be construed with a leaning in case of ambiguity in favor of the debtor.² A provision of this sort is invalid if the statute contain an explicit provision that the bonds shall not mature within a certain number of years;³ but on the other hand, where a resolution authorizing an issue of bonds provides merely that they shall mature in a certain number of years, a clause in the mortgage purporting to make the principal fall due at once upon six months' default in payment of interest is within the authority conferred by the resolution.⁴

§ 1806. **Effect of Conflict between Terms of Bonds and Terms of covering Deed of Trust as to Acceleration of Maturity.** — It has been held that where the covering deed or mortgage contains a provision that upon default for six months in payment of interest the principal shall become forthwith payable, but where no provision of the sort is found in the bonds themselves, the default in interest causes the bonds to become due for purposes of foreclosure only, and does not enable a bondholder to maintain forthwith an action at law on his bonds.⁵ And where the bonds

¹ *Chicago, etc. R. R. Co. v. Fost-dick*, 106 U. S. 47, 75 (headnote inadequate); 1 Sup. Ct. 10; *Grape Creek Coal Co. v. Farmers' L. & T. Co.*, 63 Fed. 891; 12 C. C. A. 350.

Cf. *American Loan, etc. Co. v. Union Depot Co.*, 80 Fed. 36.

² *Chicago, etc. R. R. Co. v. Fost-dick*, 106 U. S. 47, 77. As to enjoining a declaration making the principal due at once, when the mortgaged property is in the hands of receivers who have sufficient funds to pay the overdue interest, compare *Mercantile Trust Co. v.*

Baltimore & Ohio R. R. Co., 89 Fed. 606 (headnote inadequate).

³ *Howell v. Western R. R. Co.*, 94 U. S. 463.

⁴ *Coe v. New Jersey Midland Ry. Co.*, 31 N. J. Eq. 105, 118.

Cf. *Lehigh Coal, etc. Co. v. Central R. R. Co.*, 34 N. J. Eq. 88; *Farmers' L. & T. Co. v. Iowa Water Co.*, 78 Fed. 881; *Savannah, etc. R. R. Co. v. Lancaster*, 62 Ala. 555.

But see *Jesup v. City Bank*, 14 Wisc. 331.

⁵ *American Nat. Bank v. American Wood Paper Co.*, 19 R. I. 149;

provide that upon default for six months in payment of interest the principal shall become due "with the effect provided in the trust deed," the principal becomes due for no other purpose than that provided in the deed of trust — that is to say, for the purpose of enforcing the security.¹ Where the bonds provide that the principal shall become due if a default in payment of interest shall continue for six months, while the mortgage provides that upon the occurrence of a default in interest-payments the principal shall become *forthwith* payable, there is a discrepancy between the two, and therefore following the general rule² the terms of the bonds control.³

§ 1807. **Necessity for formal Action declaring Principal payable forthwith — Exercise of Election to accelerate Maturity.** — If the language is clear and unconditional, the principal becomes due upon the continuance of the default in interest for the stipulated time, without the necessity of any formal action by the bondholders or their trustee declaring the principal to be due.⁴ But if the terms of the bonds or mortgage require such a declaration before the maturity of the principal is to be deemed accelerated, the declaration is indispensable; and, moreover, the validity of the declaration must be judged as of the date when it was made, so that if a default for the required length of time had not occurred when the declaration was made, the principal would not become immediately payable because events subsequently occur which would justify a similar declaration.⁵ Where each bond provides that upon default in interest-payments the principal shall become due at the election of the holder thereof, a fore-

32 Atl. 305; 61 Am. St. Rep. 746; 29 L. R. A. 103.

Cf. *Dougan v. Evansville, etc. R. R. Co.*, 15 N. Y. App. Div. 483; 44 N. Y. Supp. 503; *Mallory v. West Shore, etc. R. R. Co.*, 35 N. Y. Super. Ct. 174.

¹ *Batchelder v. Council Grove Water Co.*, 131 N. Y. 42; 29 N. E. 801.

² See *supra*, § 1729.

³ *Railway Co. v. Sprague*, 103 U. S. 756.

⁴ *Morgan's, etc. Co. v. Texas Central Ry. Co.*, 137 U. S. 171; 11 Sup. Ct. 61.

But see *Chicago, etc. R. R. Co. v. Fosdick*, 106 U. S. 47; 1 Sup. Ct.

10. Cf. *Batchelder v. Council Grove Water Co.*, 131 N. Y. 42; 29 N. E. 801; *Baker v. Consolidated Gas, etc. Co.*, 42 N. Y. Misc. 95, 100-101; 85 N. Y. Supp. 1030 (where it was said that a provision accelerating maturity of principal for default in payment of interest could not be availed of by the company).

⁵ *Chicago, etc. R. R. Co. v. Fosdick*, 106 U. S. 47, 75 (headnote inadequate); 1 Sup. Ct. 10.

closure for non-payment of the principal is nevertheless permissible, although not quite all the bondholders concur in declaring the principal to be due.¹

§ 1808. **Waiver of Right to accelerate Maturity.** — The default in payment of interest may be waived or condoned so that the bondholder cannot subsequently set it up as causing the principal to fall due. Thus, if upon the continuance of a default for the stipulated time, a bondholder presents a petition for the winding-up of the company, which is compromised by the payment of the overdue interest, the bondholder cannot subsequently have the principal declared due on account of the same default.² So, if whether before or after default a bondholder expressly agrees, or tacitly acquiesces, in an agreement, that he and certain other bondholders shall extend the time for payment of their coupons for a period not definitely fixed, there is no default within the meaning of an acceleration clause until the consenting or acquiescing bondholder gives reasonable notice of his withdrawal of the waiver.³ The waiver of a right to exercise an option to accelerate maturity of principal on account of a default in payment of interest does not prevent an exercise of the option in the case of some subsequent default.⁴

§ 1809. **Effect of Default in paying Interest on some Bonds upon Maturity of other Bonds of the same Series.** — Usually, the intention is that where default in payment of interest upon even a single bond has continued for the specified length of time — that then the principal of all the bonds of the same series shall immediately become payable. But where the provision for accelerating the maturity of the principal was found in the bonds only, and not in the covering deed of trust, and where the phraseology of the provision was “in case of the non-payment of any interest coupon hereto attached, if such default shall continue for six

¹ *Gates v. Boston, etc. R. R. Co.*, N. Y. 501; 79 N. E. 719. Cf. *Chicago* 53 Conn. 333; 5 Atl. 695. Cf. *etc. R. R. Co. v. Fosdick*, 106 U. S. *Baker v. Consolidated Gas, etc. Co.*, 47, 73; 1 Sup. Ct. 10 (stated supra, 42 N. Y. Misc. 95, 101; 85 N. Y. Supp. 1030; *Atlantic Trust Co. v. Crystal Water Co.*, 72 N. Y. App. Div. 539; 76 N. Y. Supp. 647.

² *Melbourne Brewery & Distillery* (1901), 1 Ch. 453, 457-458 (headnote inadequate).

³ *Arnot v. Union Salt Co.*, 186

⁴ *Industrial Land Development Co. v. Post*, 55 N. J. Eq. 559; 37 Atl. 892.

As to waiver of default, see further, *Union Trust Co. v. St. Louis, etc. Ry. Co.*, 5 Dill. 1.

months after maturity and demand of payment, the principal of *this* bond shall become immediately due," the court held that a default in payment of interest accelerated the maturity of the principal of those bonds only on which interest had not been paid.¹

§ 1810. **What amounts to a Default in Payment of Interest.** — The question when a default in payment of interest within the meaning of provisions accelerating the maturity of the bonds can be deemed to have taken place has already been considered and discussed.²

It is clear that in order to constitute a default within the meaning of these provisions there must have been not merely no legal payment but also no equitable equivalent of payment by the company. Thus, where all the bonds are owned by one person who is permitted by the company to hold possession of its property as lessee but rent free, under an agreement that the net income therefrom shall be applied in payment of the maturing interest warrants, there is no default sufficient to accelerate the maturity of the principal if a true accounting between the company and the bondholder would show that the latter had received sufficient income from the property to pay the maturing coupons.³

§ 1811. **Effect of Acceleration of Maturity of Principal upon subsequently maturing Coupons.** — The consequence of acceleration of the maturity of the principal by default in interest is that all coupons not then due become cancelled; but of course interest by way of damages runs on the principal sum so long as it remains unpaid,⁴ and, at least according to some authorities, the subsequently accruing coupons represent these damages and may be assigned and sued upon separately as though the principal had not become due.⁵

§ 1812. **Effect of Acceleration upon Liability of Guarantor.** — That the principal has become due and indeed has been extinguished as an existing indebtedness by the dissolution of the company will not discharge a person who guaranteed the

¹ *Alabama, etc. Mfg. Co. v. Robinson*, 56 Fed. 690; 6 C. C. A. 79.

² *Supra*, § 1794.

³ *Chamberlain v. Connecticut Central R. R. Co.*, 54 Conn. 472; 9 Atl. 244.

⁴ *Newport, etc. Bridge Co. v. Douglass*, 12 Bush (Ky.) 673, 721-722. Cf. *supra*, § 1765.

⁵ *Welsh v. First Division St. Paul, etc. R. R. Co.*, 25 Minn. 314.

regular payment of the interest on the bonds or debentures, from his continuing obligation to pay interest as if the principal debt were still in existence.¹

§ 1813. **Acceleration of Maturity for Defaults other than Non-payment of Interest.** — A provision in a covering deed of trust to secure an issue of debenture stock that the principal shall become due if the company commit a breach of any covenant contained in the deed will be construed to apply only to breaches of the express covenants contained in the deed — the stipulations which are called covenants in the deed itself — and not to all the numerous obligations which the company brings itself under by the deed, such as the obligation to carry on its business to the best advantage.²

Sometimes bonds or debentures provide that the principal may be declared due if any execution be sued out against the property of the company and the company do not forthwith pay the judgment. Under such a provision, it is immaterial that the judgment was suffered by default for the purpose of enabling the principal of the bonds to be declared payable; it is only necessary that there shall be a *bona fide* judgment and not a mere sham based on a fictitious indebtedness.³

§ 1814. **Acceleration by Winding-up or Dissolution of the Corporation.** — In England, the law is established that the winding-up and dissolution of a company causes all its outstanding obligations, including bonds and debentures, to mature forthwith notwithstanding by their terms they may have a longer time to run.⁴ The same rule has been applied in a recent Maryland case where the mortgage expressly provided that except in certain contingencies, none of which had happened, the principal of the bonds should not become due before the time fixed for their payment.⁵ This conclusion is certainly supported by very

¹ *Re Fitzgeorge* (1905), 1 K. B. 859; *Wallace v. Universal Automatic, etc. Co.* (1894), 2 Ch. 547; 462.

² *Melbourne Brewery & Distillery* (1901), 1 Ch. 453, 458-459 (head-note inadequate). 1 Lindley on Companies, 6th ed. 336. See also *supra*, § 1812.

³ *Dickerman v. Northern Trust Co.* (1905), 2 Ch. 78. Cf. *Southern Brazilian, etc. Ry. Co.*, 176 U. S. 181; 20 Sup. Ct. 311. ⁵ *Union Trust Co. v. Thomas*

⁴ *Hodson v. Tea Co.*, 14 Ch. D. (Md.), 66 Atl. 450.

cogent reasoning. For instance, in a case where the mortgage does not cover all the property of the company, the bondholders are entitled after exhausting their security to share in respect to the deficiency in any assets not covered by the mortgage; and certainly it would be unjust that the law should step in, dissolve the corporation, and distribute all such assets among the general creditors years before the maturity of the bonds, so as to leave the bondholders when their bonds become due no property to look to for payment except that included in the mortgage. Moreover, a large part of the security of corporation bonds consists in the business, the undertaking or franchise, and this is dissipated by the dissolution and winding-up of the company. The most serious argument on the other side is that in many instances the contrary has been assumed by all persons interested. For instance, many lines of railway in the United States are subject to underlying mortgages securing long-term bonds which were issued by corporations long since wound-up and dissolved. Can it be that all such bonds have become due years ago in consequence of the insolvency and liquidation of the companies by which they were issued? Even though legal reasoning may lead irresistibly to that conclusion, the revolutionary nature of the result is likely to cause many courts to hesitate.

§ 1815. **Drawing Bonds by Lot for Redemption.** — Sometimes it is provided that a certain number of bonds shall periodically be drawn by lot for redemption. Under a provision of this sort the company cannot by buying in some of the bonds increase the chance that any one of the other bonds shall be drawn for redemption; but on the contrary all bonds which are bought in by the company must be treated for this purpose as still outstanding and must be put into the hat together with the remaining bonds when the drawing for redemption occurs.¹ In such cases there is usually a provision that notice shall be given by advertisement of the bonds to be redeemed. The advertisement must strictly comply with this provision, or the company will not be entitled to insist on the acceleration of maturity.²

¹ *Missouri, etc. Ry. Co. v. Union* ² Cf. *First Nat. Bank v. Orinoco Trust Co.*, 156 N. Y. 592; 51 N. E. *Shipping, etc. Co.*, 21 Times L. 309.

§ 1816. **Sinking Funds.** — Not infrequently provision is made for the accumulation of a sinking fund for the ultimate payment of the bonds or debentures. Sometimes this sinking fund remains under the control of the company, but more often it is to accumulate in the hands of some person as trustee, generally in the hands of the trustee under the mortgage or deed securing the bonds. A trust of this sort does not differ materially from any other trust in favor of a numerous and constantly changing body of *cestuis que trust*. If the deed creating the trust contain stipulations as to the securities in which the fund shall be invested, a court of equity has no power to authorize different investments unless all the bondholders assent or at any rate are parties to the case.¹ Sinking funds accumulated for the payment of bonds or debentures are trust funds.² Outstanding bonds do not necessarily become due or redeemable merely because sufficient money to pay them off has been paid into the sinking fund, or is owing by the company to the sinking fund.³

§ 1817. **Payment of Lost Bonds.** — If a bond is lost, the owner upon tendering a sufficient bond of indemnity may compel payment, as in other cases of lost negotiable instruments.⁴

§ 1818. **Provisions naming a Place for Payment.** — If a place for payment is named in the bonds or debentures, the company is not in default until demand is there made,⁵ but this rule has been declared to have no application where the company's insolvency and lack of funds at the place designated for payment is established.⁶ And of course, if bonds are payable at the office of the company in a certain city, and the company ceases to have an office in that city, a demand elsewhere is sufficient.⁷

§ 1819. **Premium or Bonus payable on Payment or Redemption.** — Sometimes bonds or debentures provide that under certain

¹ *Fidelity, etc. Co. v. United, etc. Louisville*, 83 Ky. 285; 4 Am. St. Canal Co., 36 N. J. Eq. 405; *Clark v. St. Louis, etc. R. R. Co.*, 58 How. Pr. (N. Y.) 21. As to reissue of lost bonds, see supra, § 1717.

² *Central R. R., etc. Co. v. Farmers' L. & T. Co.*, 116 Fed. 700.

³ *Missouri, etc. Ry. Co. v. Union Trust Co.*, 156 N. Y. 592; 51 N. E. 309; *Chicago, etc. R. R. Co. v. Pyne*, 30 Fed. 86.

⁴ *Miller v. Rutland, etc. R. R. Co.*, 40 Vt. 399; 94 Am. Dec. 413.

But see *Bainbridge v. City of R. Co.*, 67 N. Car. 198.

⁵ *Thorn v. City Rice Mills*, 40 Ch. D. 357. Cf. *Emlen v. Lehigh Coal, etc. Co.*, 47 Pa. St. 76; 86 Am. Dec. 518.

But see *Langston v. S. Car. R. R. Co.*, 2 S. Car. 248.

⁶ *Shaw v. Bill*, 95 U. S. 10, 14-15.

⁷ *Alexander v. Atlantic, etc. R.*

conditions of payment or redemption the holder shall be entitled to demand a premium or bonus in addition to the face value of the bond.¹

§ 1820. **Reissue or Revival of Paid or Redeemed Bonds.**—

When bonds have once been paid, the lien of them cannot be revived to the prejudice of other bondholders or creditors. Whether or not a transfer or deposit of bonds operates as discharge and extinguishment is a question which often arises in connection with reorganization or refunding schemes, and its bearing upon that subject is discussed below.² A transfer to the company itself after maturity certainly works a discharge of the bonds. Whether or not a transfer to the company before maturity extinguishes the bond is a question on which the authorities are not in entire harmony, but according to the English cases it does have that effect.³ Indeed, even bonds which have been issued as collateral security and redeemed by paying the mortgage debt cannot be sold or reissued so as to rank *pari passu* with the other bonds of that series.⁴ A very recent case carries this principle to the extreme of holding that where bonds are issued as collateral security for a debt equal to or exceeding their face value, and where, after the debt has been partly paid off, a new debt is contracted for which it is agreed that the bonds shall likewise stand as security, effect cannot be given to this agreement so as to enable the creditor to hold the bonds after the original debt has been completely discharged.⁵

¹ Cf. *South African Supply, etc. Co.* (1904), 2 Ch. 268 (where a premium or bonus was payable in the event of winding-up for the purpose of reconstruction or amalgamation).

² *Infra*, § 2089. Cf. § 2086.

³ *Lister v. Henry Lister & Sons*, 62 L. J. Ch. 568; *George Routledge & Sons* (1904), 2 Ch. 474 (where registered bonds having been transferred to the company by an endorsement upon them were transferred or reissued to a purchaser); *W. Tasker & Sons* (1905), 2 Ch. 587 (where registered bonds were transferred in blank and then by the company transferred to a purchaser); *Perth Electric Tramways* (1906), 2 Ch. 216 (a similar case,

where the second taker of the debentures had no knowledge of any prior dealing with them by the company.)

But see *Claflin v. South Carolina R. R. Co.*, 8 Fed. 118; *Re Fifty-four First-Mortgage Bonds*, 15 S. Car. 304.

See *infra*, § 1896 and § 1848. Cf. *Fidelity Ins., etc. Co. v. Shenandoah Valley R. R. Co.*, 33 W. Va. 761; 11 S. E. 58; *M. A. Furbush, etc. Co. v. Liberty Woolen Mills*, 81 Fed. 425.

⁴ *W. Tasker & Sons* (1905), 2 Ch. 587; *Perth Electric Tramways* (1906), 2 Ch. 216. See *supra*, § 1699.

⁵ *Russian Petroleum & Liquid Fuel Co. v. London Investment Trust* (1907), 2 Ch. 540.

On the other hand, bonds which have been bought in by the company must be treated as still outstanding where so to treat them is advantageous to the other bondholders.¹ Moreover, as stated above, a mere exchange of engraved for lithographed bonds is not deemed a cancellation and reissue.²

In England, by a recent statute, power is conferred, subject to certain conditions, to reissue redeemed debentures so as to confer on the holders the same rights and priorities as if the instruments had not been redeemed.³ The fact that the English law as laid down by judicial decision was found so inconvenient as to induce this prompt legislative intervention may perhaps be taken to indicate that the decisions in question were unduly narrow, especially as some American cases have taken a broader view.⁴

§ 1821-§ 1825. *Convertible Bonds — Conversion into Capital Stock in lieu of Payment in Money.*

§ 1821. **In general.** — Sometimes, instead of ultimate payment in money, bonds provide for their conversion into shares of capital stock or some other security. Such bonds are called convertible bonds.⁵ The conversion may be at the election either of the company or of the holder. In the former case, if the company fails to exercise the privilege at the proper time, the obligation to make payment in cash remains absolute, and therefore the holder may recover as his damages for non-payment the principal of the bond with interest.⁶ If the option rests with the holder, it constitutes a right which may be very valuable, and which may be exercised by any individual holder without the concurrence of the other bondholders.⁷

¹ *Missouri, etc. Ry. Co. v. Union Trust Co.*, 156 N. Y. 592; 51 N. E. 309. *tral R. R. Co.*, 7 Bosw. (N. Y.) 515 (issue of bonds convertible at option of holder held lawful).

² *Supra*, § 1718.

³ Companies Act, 1907, § 15, construed and applied in *Fitzgerald v. Persse* (1908), 1 Ir. 279; *New London, etc. Co.* (1908), 1 Ch. 621.

⁴ See *supra*, p. 1473, n. 3.

⁵ As to the legality of a provision for conversion into shares, see *Wall v. Utah Copper Co.* (N. J.), 62 Atl. 533 (issue of bonds convertible at option of company held illegal); *Van Allen v. Illinois Cen-*

For discussion of the questions involved, see *supra*, § 223.

As to the objection that the old shareholders are deprived of their pre-emptive right to new shares, see *supra*, § 604.

⁶ *Pusey v. New Jersey, etc. R. R. Co.*, 14 Abb. Pr. N. S. (N. Y.) 434, 440.

Cf. *First Nat. Bank v. Orinoco Shipping, etc. Co.*, 21 Times L. R. 39.

⁷ *Bratten v. Catawissa R. R. Co.*, 211 Pa. 21; 60 Atl. 319.

§ 1822. **Remedies for wrongful Refusal of the Company to make the Conversion.** — It has been held that in the absence of special circumstances specific performance of a provision for the conversion of bonds into stock should not be decreed against the company, but that the bondholder should be left to his action for damages.¹ It is no answer to such an action for damages that the company has no stock under its control and can procure none except at an exorbitant price.² The plaintiff in such an action must allege and prove that he owned the bonds in question both at the time of the demand for conversion and at the time of suit;³ for if he transfers the bond, the right of conversion passes to the transferee. The acceptance of interest accruing after the refusal of the company on demand to convert the bonds into shares would seem to be a waiver of any rights growing out of that refusal although the holder might renew the demand at any subsequent time before his option expires.⁴

§ 1823. **Consequences of Consolidation with another Corporation upon Bondholders' Right of Conversion.** — The mere fact that the holders of bonds have an option to exchange their bonds for shares of capital stock does not prevent the company from consolidating with another corporation under laws in force when the bonds were issued, and thus obliterating the capital stock; but before any such consolidation can take place, the bondholders must have distinct notice of the intended amalgamation and its terms, and an opportunity must be given them of exercising their option before the privilege is cut off.⁵ If the bondholder takes an active part in bringing about the consolidation, or even lies quietly by while it is accomplished, without exercising his option, he cannot subsequently recover damages from the consolidated

¹ *Chaffee v. Middlesex R. R. Co.*, 146 Mass. 224; 16 N. E. 34.

But *quære* whether specific performance should not be decreed. Cf. *Campbell v. London & Brighton Ry. Co.*, 5 Hare 519 (where specific performance was refused but solely on the ground that the option had not been exercised in time). See also *supra*, § 234.

As to the measure of damages, see *Van Allen v. Illinois Central R. R. Co.*, 7 Bosw. (N. Y.) 515, 537.

² *Bratten v. Catawissa R. R. Co.*, 211 Pa. St. 21; 60 Atl. 319.

³ *Denney v. Cleveland, etc. R. R. Co.*, 28 Oh. St. 108.

⁴ *Denney v. Cleveland, etc. R. R. Co.*, 28 Oh. St. 108 (headnote inadequate).

⁵ *Rosenkranz v. Lafayette, etc. Ry. Co.*, 18 Fed. 513.

Cf. *Parkinson v. West End Street Ry. Co.*, 173 Mass. 446; 53 N. E. 891.

corporation for its failure to do the impossible, namely, to give him shares in the original corporation in exchange for his bonds.¹ In one instance, where the consolidation was effected upon the footing of entire equality between shares in the two constituent companies, the court held, that the bondholder was entitled to demand the same number of shares in the new company as he might have had in the old company; ² this conclusion was based upon the proposition that by the terms of the statute under which the consolidation was had the consolidated company was identical with the old company with an increased capital, and that shares in the old company if delivered would at once have been convertible into shares in the new, share for share.³

§ 1824. **Time and Manner of Exercise by Bondholder of Option of Conversion.** — The bondholder's option must be exercised strictly within the time limited and prescribed.⁴ But he may exercise the option by a communication transmitted to the company's office after three o'clock in the afternoon — the usual hour of closing — on the last day.⁵ Where the bonds provide that the option may be exercised at any time before a certain date, which date is also the day on which the bonds mature, a subsequent agreement extending the time for payment does not by implication extend the time for the exercise of the option.⁶ If no time is fixed for the termination of the bondholder's option to exchange his bonds for shares, it must be exercised before the maturity of the bonds.⁷ Where appended to the option is a note that the

¹ *Tagart v. Northern Central Ry. Co.*, 29 Md. 557.

But see *Cayley v. Coburg, etc. Ry. Co.*, 14 Grant Ch. (Can.) 571.

² *John Hancock, etc. Ins. Co. v. Worcester, etc. R. R. Co.*, 149 Mass. 214; 21 N. E. 364; *Day v. Worcester, etc. R. R. Co.*, 151 Mass. 302; 23 N. E. 824.

³ See *Parkinson v. West End Street Ry. Co.*, 173 Mass. 446; 53 N. E. 891 (where the Worcester Railroad Cases were distinguished and explained as resting upon peculiar facts).

⁴ *Chaffee v. Middlesex R. R. Co.*, 146 Mass. 224; 16 N. E. 34 (time expired on Sunday, option sought to be exercised on Monday); *Camp-*

bell v. London & Brighton Ry. Co., 5 Hare 519; *Carpenter v. Chicago, etc. Ry. Co.*, 104 N. Y. Supp. 152.

⁵ *Chaffee v. Middlesex R. R. Co.*, 146 Mass. 224; 16 N. E. 34 (semble).

⁶ *Muhlenberg v. Philadelphia, etc. R. R. Co.*, 47 Pa. St. 16.

⁷ *Loomis v. Chicago, etc. Ry. Co.*, 102 Fed. 233; 42 C. C. A. 290 (where

the provision was that the bond might be exchanged for shares at any time within ten days after any dividend should be declared on the preferred stock of the company); *Carpenter v. Chicago, etc. Ry. Co.*, 104 N. Y. Supp. 152 (same point as last case).

As to the time for exercising the option where no time is fixed by

conversion must be effected if at all before "1st January 185-," the legal consequences, it seems, are the same as if nothing had been said as to the termination of the option.¹

§ 1825. **Effect of Consummation of Conversion.** — Where, according to the terms of convertible bonds, they are converted into shares of capital stock, the holders become from that time forth entitled to the same rights as other shareholders so that they may demand their proportion of all dividends, whether payable in cash or stock, thereafter declared, although the profits out of which the same are to be paid were earned before the conversion of the bonds, and although the directors had previously resolved that the fiscal year for purposes of dividends should close on a day prior to that on which the conversion took place.² Of course, the former bondholder has no retroactive right to participate in a stock dividend which was declared before the conversion,³ or in the pre-emptive rights of shareholders upon an increase of capital made before that time.⁴ Conversely, the conversion when completed puts an end to his rights as a creditor, so that he cannot afterwards retrace his steps in whole or in part, or claim any rights of a creditor as distinguished from those of a shareholder or member.⁵

the terms of the bond, see further,
Van Allen v. Illinois Central R. R.
Co., 7 Bosw. (N. Y.) 515.

³ *Sutliff v. Cleveland, etc. R. R.*
Co., 24 Oh. St. 147.

¹ *Van Allen v. Illinois Central*
R. R. Co., 7 Bosw. (N. Y.) 515, 536.

⁴ *Pratt v. Am. Bell Tel. Co.*, 141
Mass. 225; 5 N. E. 307; 55 Am. St.
Rep. 465. See supra, § 605.

² *Jones v. Terre Haute, etc. R. R.*
Co., 57 N. Y. 196.

⁵ See supra, § 542.

CHAPTER XXIX

BONDS AND MORTGAGES (CONTINUED) — THE SECURITY

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§ 1826—§ 1885. THE MORTGAGE, CHARGE, OR SECURITY, IN GENERAL.

§ 1826—§ 1849. CHARGE OR SECURITY CREATED BY A FORMAL DEED OF TRUST.

§ 1826. **In general.** — In many ways the most important feature of bonds or debentures — the feature which gives to them their chief value — is the security, mortgage, or charge by which a priority over the general creditors of the company is assured. Indeed, in some cases bonds contain a provision that the bondholders shall look for payment to the security alone and that the company shall be under no personal liability.¹ That in America the security takes the form of a covering deed of trust in the nature of a mortgage to secure all the bonds of a

¹ *Farmers' L. & T. Co. v. Penn* an objection to the negotiability of *Plate Glass Co.*, 186 U. S. 434; 22 such bonds, see *supra*, § 1740 A. Sup. Ct. 842. Cf. *infra*, § 2039. For

given series has been already pointed out. In most of its attributes and incidents, this trust does not differ from any other trust. After the trust for the bondholders begins, the rights, duties, powers and liabilities of the trustees so far as they are fixed by law do not differ essentially from those of other trustees.

§ 1827-§ 1844. THE TRUSTEE.

§ 1827-§ 1829. *The Trustee as the Representative of the Bondholders in Litigation.*

§ 1827. **In general.**—Like other trustees, the trustees of a deed of trust securing an issue of bonds represent their beneficiaries in all litigation connected with the trust.¹ For example, the trustee is the proper party to institute any legal proceedings that may be necessary for the enforcement² or protection³ of the security; and there is no necessity for making the bondholders parties.⁴ If, however, the trustee in a proper case neglects or refuses to institute the requisite proceedings for the protection or enforcement of the trust, then, as in any similar case in any other trust, any bondholder or *cestui que trust* may step in and file a bill instead of the delinquent trustee,⁵ making the trustee a party defendant.⁶ Any bondholders who refuse to join as complainants may be made defendants, but this is not necessary—at all events, not necessary in a case where those bondholders are non-residents.⁷ Except in case of a refusal of the trustee to institute proper proceedings, or in case of his disqualification, an individual bondholder cannot sue for the pro-

¹ *Winslow v. Minnesota, etc. R. R. Co.*, 4 Minn. 313; 77 Am. Dec. 519; *McElrath v. Pittsburg, etc. R. R. Co.*, 68 Pa. St. 37.

² See *infra*, § 1966.

³ *Murdock v. Woodson*, 2 Dillon 188 (affirmed in *Woodson v. Murdock*, 22 Wall. 351); *Old Colony Trust Co. v. City of Wichita*, 123 Fed. 762; *Louisville, etc. R. R. Co. v. Schmidt* (Ky.), 107 S. W. 745.

Cf. *Illinois Trust, etc. Bank v. Minton*, 120 Fed. 187 (where the court refused to entertain a bill to

restrain strikers from intimidating employees of the company). As to the right of a bondholder to interfere in the management of the company, see *infra*, § 1928.

⁴ *Vose v. Bronson*, 6 Wall. 452, 456 (semble). See *infra*, § 1966.

⁵ *Chicago, etc. R. R. Co. v. Fostick*, 106 U. S. 47, 68; 1 Sup. Ct. 10 (semble). See *infra*, § 1967.

⁶ *Hotel Co. v. Wade*, 97 U. S. 13. See *infra*, § 1967.

⁷ *Hotel Co. v. Wade*, 97 U. S. 13. See *infra*, § 1967.

tection¹ or enforcement of the security.² Suits for the protection of the security are governed by the same principles as suits for the enforcement of the security, which latter class of suits is the subject of detailed consideration below.³

§ 1828. **Bondholders bound by Decree wherever Trustee is bound.** — A necessary result of the power of the trustee to represent the bondholders in litigation in reference to the trust is that if the trustee acts in good faith, whatever binds him in legal proceedings binds the bondholders.⁴ This rule apparently applies even where the trustee has some individual interest of his own in the proceedings,⁵ or where he is also trustee for another set of bondholders who have antagonistic interests.⁶ Hence, the trustee's release of errors in a decree binds all the bondholders, and an individual bondholder, even with leave of the lower court, cannot thereafter appeal in the name of the trustee from that decree.⁷ Hence, too, a decree of foreclosure for principal and interest obtained by the trustee when interest only was overdue binds the several bondholders.⁸ A decision against the trustee will not, however, bind the bondholders as to property not included in the trust.⁹

§ 1829. **Rule in Cases where Rights of Bondholders inter sese are involved.** — This principle of the representation of the bondholders by the trustee should have, however, no application where not the collective or general rights of the bondholders are involved in the litigation, but their individual rights *inter sese*.

¹ *Consolidated Water Co. v. City of San Diego*, 89 Fed. 272.

But see *D. A. Tompkins Co. v. Catawba Mills*, 82 Fed. 780.

² See *infra*, § 1967.

³ *Infra*, § 1966 et seq.

⁴ *Corcoran v. Chesapeake, etc. Canal Co.*, 94 U. S. 741; *Richter v. Jerome*, 123 U. S. 233; 8 Sup. Ct. 106; *Beals v. Illinois, etc. R. R. Co.*, 133 U. S. 290; 10 Sup. Ct. 314; *Kent v. Lake, etc. Co.*, 144 U. S. 75; 12 Sup. Ct. 650; *Young v. Montgomery, etc. R. R. Co.*, 2 Woods 606; *Campbell v. Railroad Co.*, 1 Woods 368; *Board of Supervisors v. Mineral Point R. R. Co.*, 24 Wisc. 93; *McElrath v. Pittsburg, etc. R. R. Co.*, 68 Pa. St. 37; *Fletcher v. Ann Arbor*

R. R. Co., 116 Fed. 479; 53 C. C. A. 647; *Mayor, etc. of Baltimore v. United Rys., etc. Co. (Md.)*, 69 Atl. 436.

Cf. Taylor v. Atlantic, etc. R. R. Co., 57 How. Pr. (N. Y.) 26, 39.

⁵ *Shaw v. Railroad Co.*, 100 U. S. 605.

Cf. Corcoran v. Chesapeake, etc. Canal Co., 94 U. S. 741, 745.

⁶ *Robinson v. Iron Ry. Co.*, 135 U. S. 522, 531; 10 Sup. Ct. 907.

⁷ *Elwell v. Fosdick*, 134 U. S. 500; 10 Sup. Ct. 598.

⁸ *Credit Co. v. Arkansas, etc. R. R. Co.*, 15 Fed. 46.

⁹ *National Salt Co. v. Ingraham*, 143 Fed. 805.

It is true that, in one case, this distinction, which is submitted to be undoubtedly sound, was overlooked by a federal judge;¹ but his decision would hardly be followed.

§ 1830. **Whether Trustee is Agent of Bondholders — Notice to Trustee as Notice to Bondholders.** — The trustee is not to be deemed an agent for the several bondholders.² To be sure, in some cases, the contrary proposition has been laid down, and made the ground for holding that the bondholders take subject to a prior equitable encumbrance of which their trustee had notice;³ but the weight of reason leans decidedly to the view that notice to the trustee cannot be deemed notice to the bondholders.⁴

§ 1831. **Powers vested in Trustee.** — As will be explained in detail hereafter,⁵ trustees of corporation mortgages are often intrusted with important powers, particularly in regard to taking possession of the mortgaged property and selling the same. When the trustees are several in number a question may arise whether, upon the retirement of one or more by death or otherwise, the powers pass to the survivors.⁶ The question is, of course, one of intention, to be gathered from the language of the deed of trust, construed in the light of the general principles of equity and of the law of powers. Powers vested in the trustees may be executed by them after the dissolution of the corporation.⁷ In the absence of very clear express powers the trustees have no power to waive defaults or otherwise alter or directly affect the rights of the bondholders.⁸

¹ *Pollitz v. Farmers' L. & T. Co.*, 53 Fed. 210.

² *Commissioners of Johnson Co. v. Thayer*, 94 U. S. 631, 644-645; *Unity Co. v. Equitable Trust Co.*, 204 Ill. 595; 68 N. E. 654.

Cf. *Barrett v. Twin City Power Co.*, 118 Fed. 861; *Romare v. Broken Arrow, etc. Mining Co.*, 114 Fed. 194, 197-198 (trustee no power to bind bondholders by agreeing not to foreclose).

³ *Miller v. Rutland, etc. R. R. Co.*, 36 Vt. 452; *Haven v. Emery*, 33 N. H. 66.

⁴ *National Waterworks Co. v. Kansas City*, 78 Fed. 428.

⁵ See *infra*, § 1961-§ 1964.

⁶ See *Shaw v. Norfolk, etc. R. R. Co.*, 5 Gray 162.

⁷ *Nelson v. Hubbard*, 96 Ala. 238; 11 So. 428; 17 L. R. A. 375.

⁸ *Hollister v. Stewart*, 111 N. Y. 644; 19 N. E. 782.

§ 1832-§ 1838. *Liabilities of the Trustee.*

§ 1832. **In general.** — The trustee under a corporation mortgage is subject to the same duties and liabilities as other trustees.¹ He is bound to see that the mortgage is duly recorded, and if through neglect of this duty a subsequent encumbrance obtains priority, he is liable to the bondholders for the resulting loss.²

Particularly, the trustee is under an obligation to be diligent in the protection³ and enforcement of the security, and this duty he cannot delegate to others. For instance, he should not refuse to institute proper legal proceedings for the enforcement of the charge. If he does neglect or refuse to do so, and proceedings are instituted for that purpose by one of the bondholders, and loss is occasioned to the other bondholders by the manner in which such proceedings are conducted by the plaintiff therein, the trustee will be answerable for such loss.⁴

§ 1833. **Liability for departing from Course of Action prescribed by Deed of Trust.** — For any departure from the course of action prescribed by the deed, the trustee is liable. For instance, where the deed provides that in case of a purchase by the trustee for the benefit of the bondholders at a foreclosure sale, the trustee shall proceed to take the necessary steps to organize the bondholders into a corporation; if the trustee, instead of doing so, sells the property at auction, he is liable for the value of the interest of the bondholders who do not concur in such a sale.⁵ So, where a deed of trust provides that a purchase by the trustee shall enure to the benefit of all the bondholders who may contribute to the expenses of the sale and foreclosure, a trustee who after

¹ The duties of trustees under corporation mortgages were the subject of elaborate and able discussion in *Sturges v. Knapp*, 31 Vt. 1. Cf. *Racine, etc. R. R. Co. v. Farmers' L. & T. Co.*, 49 Ill. 331; 95 Am. Dec. 595.

As to the duty of the trustee to give information concerning the security to the bondholders, see *Pronick v. Metropolitan Trust Co.*, 67 N. Y. App. Div. 616; 74 N. Y. Supp. 577.

As to the liability of the trustee

for wrongfully certifying bonds for issue, see supra, § 1710-§ 1714.

² *Miles v. Vivian*, 79 Fed. 848; 25 C. C. A. 208 (where the claim was held barred by limitations).

³ Cf. *Frishmuth v. Farmers' L. & T. Co.*, 107 Fed. 169; 46 C. C. A. 222 (where the trustee was held not liable on the facts).

⁴ *Merrill v. Farmers' L. & T. Co.*, 24 Hun (N. Y.) 297.

⁵ *James v. Cowing*, 82 N. Y. 449.

purchasing the property conveys it to another corporation is guilty of a breach of trust.¹

§ 1834. **Liability for wrongfully delivering Bonds to the Company for Issue.** — If the mortgage provides that certain of the bonds shall be held by the trustee and delivered to the company only upon the production of a detailed statement of the uses to which they are to be put, the trustee violates his duty if any of the bonds are delivered to the company without the production of such an account;² but the duty so violated has been held to be a duty springing out of the relationship of trustee and *cestui que trust* and not out of any express or implied covenant contained in the deed of trust.³ If some of the bonds have been regularly issued, a breach of duty on the part of the trustee in delivering other bonds to the company for issue without taking adequate precautions in respect to the application of the proceeds will confer a right of action on the holders of the bonds previously issued and also on the holders of the newly issued bonds.⁴

§ 1835. **Liability for Failure to secure further Assurance of after-acquired Property.** — The fact that the deed of trust contains the usual after-acquired property clause and a covenant for further assurance does not cast upon the trustee the burden of watching the conduct of the corporation and of taking notice of all that the company does with its property and funds.⁵

§ 1836. **Provisions restricting Liabilities of Trustees.** — Provisions are often found limiting the liability of the trustee for negligence in the administration of the trust,⁶ excusing him from taking any action unless indemnified against loss, etc. How far these provisions are efficacious is not altogether clear.⁷ It has been held that a stipulation exempting the trustee from any

¹ *Zebley v. Farmers' L. & T. Co.*, 95 Fed. 5, 10 (headnote inadequate). Cf. s. c. in *C. C. A.*, 107 139 N. Y. 461; 34 N. E. 1067.

² Cf. *Frishmuth v. Farmers' L. & T. Co.*, 95 Fed. 5. See s. c. in *C. C. A.*, 107 Fed. 169. ⁵ *National Waterworks Co. v. Kansas City*, 78 Fed. 428.

³ *Rhineland v. Farmers' L. & T. Co.*, 172 N. Y. 519; 65 N. E. 499. ⁶ Cf. *Hollister v. Stewart*, 111 N. Y. 644; 19 N. E. 782.

Cf. *Frishmuth v. Farmers' L. & T. Co.*, 95 Fed. 5; 107 Fed. 169; 46 *Tschetinian v. City Trust Co.*, 89 N. Y. Supp. 1053; 97 N. Y. App. Div. 380 (affirmed 186 N. Y. 432; *C. C. A.* 222.

⁴ *Frishmuth v. Farmers' L. & T.* 79 N. E. 401).

liability except for his own wilful and intentional breaches of trust excuses him from any responsibility for mere mistakes or misconceptions of his obligations;¹ but at all events such provisions do not invalidate the bonds or mortgage.²

§ 1837. **Frame of Action or Suit to enforce Liability of the Trustee.** — The trustees of a corporation mortgage are bound to account to any one of the *cestuis que trust* or to all of them collectively for any moneys which have come to their hands in the execution of their trust and which are applicable to the payment of the bonds.³ Ordinarily, however, the trustee cannot be made liable for a breach of trust in a suit brought by a single bondholder on his own account, but the suit should be brought on behalf of all the bondholders.⁴ Where the breach of trust is committed by one of several trustees, the co-trustees and not the bondholders are the proper parties to institute proceedings.⁵ The company is not a necessary party to the suit.⁶ The trustee is never liable for any act or breach of trust to any bondholder who concurred therein.⁷ The liability of the trustee for misconduct can be enforced only in a proceeding framed for that object, and cannot be enforced upon a cross-bill filed by a bondholder in a suit for foreclosure.⁸

§ 1838. **Defence of Statute of Limitations.** — The liability of the trustee to the bondholders or *cestuis que trust*, in the absence of some express covenant in the deed of trust arises merely out of the equitable relationship and cannot be treated as springing from a breach of covenant so as to bring the claim within a twenty-year period of limitations applicable to actions on sealed instruments.⁹ As the trust is formal and express, the

¹ *Black v. Wiedersheim*, 143 Fed. 359.

² *Stainback v. Junk Bros., etc.* Co., 98 Tenn. 306, 321-322; 39 S. W. 530.

Cf. *Stanton v. Alabama, etc. R. R. Co.*, 2 Woods 523.

³ *Dwight v. Smith*, 13 Fed. 50. Cf. *Dwight v. Smith*, 9 Fed. 795, criticised supra, § 1759.

⁴ *Frishmuth v. Farmers' L. & T. Co.*, 95 Fed. 5. Cf. s. c. in C. C. A., 107 Fed. 169; 46 C. C. A. 222.

⁵ *Weetjen v. Vibbard*, 5 Hun (N. Y.) 265.

⁶ *Frishmuth v. Farmers' L. & T. Co.*, 95 Fed. 5. Cf. s. c. in C. C. A., 107 Fed. 169; 46 C. C. A. 222.

⁷ *Butterfield v. Cowing*, 112 N. Y. 486; 20 N. E. 369.

⁸ *Fidelity Trust, etc. Co. v. Mobile Street Railway Co.*, 53 Fed. 850.

⁹ *Frishmuth v. Farmers' L. & T. Co.*, 107 Fed. 169; 46 C. C. A. 222; *Rhineland v. Farmers' L. & T. Co.*, 172 N. Y. 519; 65 N. E. 499.

ordinary rule would exempt the action or suit from the provisions of any statute which is not expressly declared to be applicable to trustees.

§ 1839. **Expenses incurred by the Trustee — Counsel fees, etc.**

— Like other trustees, the trustees of a corporation mortgage are entitled to reimbursement or allowance out of the trust estate for any costs and expenses properly incurred by them¹ in the administration of the trust, such, for example, as counsel fees.² Hence, if for the protection of their beneficiaries they pay off a prior encumbrance, they are entitled to be subrogated thereto to the extent of their expenditure, with legal interest thereon.³

The ordinary and natural application of this principle of the trustee's right to reimbursement for his expenses is only between himself and the bondholders. That is to say, the expenses are properly chargeable only upon funds payable to the bondholders, the *cestuis que trust*, and not upon funds payable to the company, its shareholders, or its general creditors. Hence, where the corporation exercises its right of redemption, it cannot be required to pay the trustee's expense of insuring the mortgaged property⁴ or to reimburse him for counsel fees expended by him in order to get possession of the property.⁵ On the other hand, if,

¹ *Rensselaer, etc. R. R. Co. v. Co.*, 70 Cal. 144; 11 Pac. 590; *Central Trust Co. v. Wabash, etc. Ry. Co.*, 36 Fed. 622; *Girard Life Ins. Co. v. Annuity, etc. Iron Co.*, 20 Pa. Super. Ct. 304; *Phinizy v. Augusta, etc. R. Co.*, 98 Fed. 776.
But see *Investment Co. v. Ohio, etc. R. R. Co.*, 46 Fed. 696.

² *Woodruff v. New York, etc. R. R. Co.*, 129 N. Y. 27; 29 N. E. 251; *Jones v. Central Trust Co.*, 73 Fed. 568, 573-574; 19 C. C. A. 569. As to any right to be indemnified by the individual bondholders, see *Central Trust Co. v. Louisville Trust Co.*, 87 Fed. 23.

³ *Woodruff v. New York, etc. R. R. Co.*, 129 N. Y. 27; 29 N. E. 251; *Easton v. Houston, etc. Ry. Co.*, 40 Fed. 189; *Louisville, etc. R. R. Co. v. Schmidt* (Ky.), 107 S. W. 745 (holding that a bondholder who was defendant in the litigation must bear his proportion of the counsel fees).

⁴ *Boston, etc. R. R. Corp. v. Haven*, 8 Allen (Mass.) 359.
⁵ *Boston, etc. R. R. Corp. v. Haven*, 8 Allen (Mass.) 359.

Cf. *Schallard v. Eel River Nav. Co.*, 70 Cal. 144; 11 Pac. 590; *Coe v. Columbus Piqua, etc. R. R. Co.*, 10 Oh. St. 372, 408-409; 75 Am. Dec. 518.

Cf. Schallard v. Eel River Nav.

as is sometimes the case, the deed of trust contains a covenant by the obligor company to pay all costs, charges, and expenses which the trustee may incur in and about the execution of the trust, the trustee is entitled to recover from the company his counsel fees in a foreclosure suit.¹ And, even without such an express covenant, a provision in the mortgage or deed of trust that the trustee shall be allowed for his own compensation as well as for certain classes of expenditures will have the effect of putting all such charges on the company and of including them, in addition to the principal and interest of the bonds, within the lien of the mortgage.²

§ 1840-§ 1842. *Compensation of the Trustee.*

§ 1840. **In general.** — In respect to their right to compensation, for their time and trouble, trustees under corporation mortgages stand in the main upon the same footing as other conventional trustees.³

§ 1841. **By whom payable.** — As to whether this compensation is payable by the company or the bondholders the same considerations adverted to in a former paragraph⁴ would seem to be applicable. However, in a recent English case it was held that when the covering deed of trust contains a covenant on the company's part to pay the trustee's compensation, there is no obligation to do so resting upon the debenture-holders, so that the trustee's compensation cannot be allowed out of the proceeds of sale realized in a debenture-holder's action.⁵ Perhaps this decision was partly influenced by the English rule that trustees cannot without some affirmative provision demand any compensation out of the trust estate.

§ 1842. **Amount of Compensation — Nature of Services for which Compensation is due.** — As to the amount of their compensation, the peculiar nature of their services may properly

¹ *Memphis, etc. R. R. Co. v. Dow*, 120 U. S. 287, 302 (headnote inadequate); 7 Sup. Ct. 482.

² *Boston, etc. R. R. Corp. v. Haven*, 8 Allen (Mass.) 359.

³ *Dow v. Memphis, etc. R. R. Co.*,

32 Fed. 185. Upon the general subject, in addition to cases cited below, see *Easton v. Houston, etc. Ry. Co.*,

40 Fed. 189.

⁴ *Supra*, § 1839.

⁵ *Re Accles*, 51 W. R. 57.

affect the question, and in exceptional circumstances may even go to indicate that no compensation at all is proper. Thus, where a deed of trust to secure an issue of railway bonds contained a careful provision for commissions to the trustee in the event of a sale, but made no provision for commissions in any other event, the court held that for such services as countersigning the bonds, keeping books, etc., the trustees were entitled to no compensation, but that if the office were not accepted purely from the motive of public spirit and a desire to aid in a public improvement, then the prospect of large commissions in case of a sale must have been regarded as sufficient consideration for accepting the trust.¹ On the other hand, in Virginia, where a deed of trust securing a series of railway bonds provided that upon a sale of the property the costs and expenses of the trust should be paid out of the proceeds in preference to the bonds, the court held that compensation to the trustee for such services as countersigning the bonds should be allowed.² A claim for compensation for paying maturing coupons has been disallowed.³ In any case, compensation should be proportioned to the services actually performed; and consequently where the trustees do not take possession of the property and no duties are required of them in the collection or distribution of the proceeds of sale, the allowance should be comparatively slight although the full amount of the debt is realized.⁴ Where the trustee is entitled to a commission on all sales made by him, he may have the same commission where the purchase money is payable in bonds as if it had been payable in cash.⁵

Where a corporation agrees to designate a certain person as trustee to secure an issue of bonds at a fixed compensation, and he agrees to act as such trustee, he acquires a contractual right against the company to the stipulated compensation;⁶

¹ *Northern Central Ry. Co. v. Waterloo Organ Co.*, 147 Fed. 814; *Keighler*, 29 Md. 572.

² *Smith's Extrs. v. Washington City, etc. R. R. Co.*, 33 Gratt. 617. 355.

³ *Waterloo Organ Co.*, 147 Fed. 814. ⁵ *Gilman v. Des Moines, etc. R. R. Co.*, 41 Iowa 22.

⁴ *Phinizy v. Augusta, etc. R. Co.*, 98 Fed. 776. Cf. *D. A. Tompkins Co. v. Chester Mills*, 90 Fed. 37; ⁶ *Maury v. Chesapeake, etc. R. R. Co.*, 27 Gratt. (Va.) 698.

but he waives this right if he accepts the trusteeship under a deed which provides for a less compensation.¹

§ 1843. **Removal of Trustee — Filling Vacancies.** — The trustee can be removed,² or in case of a vacancy in the office his place can be filled, as in other cases of trusteeships, by the authority of a court of equity.³ To a proceeding of this sort the mortgagor corporation should be a party.⁴ And where the proceeding is instituted to fill a vacancy caused by the death of one of several trustees, the surviving trustees are necessary parties.⁵ Upon such a proceeding the court merely appoints a trustee for the holders of outstanding bonds, if any such there be, and hence will not consider the validity of an alleged foreclosure and reorganization.⁶ The court will not ordinarily appoint a bondholder as trustee.⁷ Sometimes, by virtue of a statute, or under a provision in the bonds or in the deed of trust, a majority of the bondholders have power to remove a trustee or to elect a new one in his room,⁸ but without an explicit provision of this sort the bondholders have no such power.⁹ Any such provisions are

¹ *Maury v. Chesapeake, etc. R. R. Co.*, 27 Gratt. (Va.) 698.

² See *Brooks v. Vermont Central R. R. Co.*, 14 Blatchf. 463; *Hughes v. Chicago, etc. Ry. Co.*, 47 N. Y. Super. Ct. 531; *Re Mechanics' Bank*, 2 Barb. (N. Y.) 446; *Harrison v. Union Trust Co.*, 144 N. Y. 326; 39 N. E. 353; *Ketchum v. Mobile, etc. R. R. Co.*, 2 Woods 532; *Clay v. Selah Valley, etc. Co.*, 14 Wash. 543, 550; 45 Pac. 141.

Cf. Beadleson v. Knapp, 13 Abb. Pr., N. S., 335 (where the court declined to remove the trustee); *Dillaway v. Boston Gaslight Co.*, 54 N. E. 359; 174 Mass. 80 (removal refused); *Washington, etc. R. R. Co. v. Alexandria, etc. R. R. Co.*, 19 Gratt. (Va.) 592; 100 Am. Dec. 710 (where an order of removal was held void).

³ *Hale v. Nashua, etc. R. R.*, 60 N. H. 333, 341 (headnote inadequate);

Re Eastern R. R. Co., 120 Mass. 412.

⁴ *Inhabitants of Anson*, 85 Me. 79; 26 Atl. 996. Where the deed of trust provides a mode of filling vacancies, that method may be followed without giving notice to the mortgagor company, *Macon, etc. R. R. Co. v. Georgia R. R. Co.*, 63 Ga. 103. *Cf. Pillsbury v. Consolidated, etc. Ry. Co.*, 69 Me. 394.

⁵ *Inhabitants of Anson*, 85 Me. 79; 26 Atl. 996.

⁶ *Inhabitants of Anson*, 85 Me. 79; 26 Atl. 996.

⁷ *William Radam Microbe Killer Co.*, 110 N. Y. App. Div. 329; 97 N. Y. Supp. 76.

⁸ *Cf. Hale v. Nashua, etc. R. R. Co.*, 60 N. H. 333 (headnote inadequate). See *infra*, § 2098.

⁹ *Re Bondholders of York & Cumberland R. R. Co.*, 50 Me. 552.

cumulative merely, and do not oust the general inherent jurisdiction of a court of equity over the appointment of trustees.¹

§ 1844. **Corporations as Trustees.** — Formerly, in the United States, prominent bankers or lawyers were usually selected as trustees under corporation mortgages; but latterly for obvious reasons of convenience the practice has been to repose the trust in some trust company. In such cases, the courts do not lend a willing ear to litigants who seek to impeach or impair the security of the bondholders because of some failure on the part of the trust company to comply with statutes requiring deposits, etc., to be made as a condition to the acceptance of trusts by any corporation.²

§ 1845. **Constructive Notice to Bondholders of Contents of Deed of Trust.** — It has been said that where bonds refer to the covering deed of trust, as they invariably do, the several bondholders are charged with constructive notice of all the facts that the deed discloses.³ But this doctrine is qualified by the rule that the bondholder is not obliged to suspect that the mortgage contains any provisions inconsistent with the tenor of the bonds, and by the rule that in any case of irreconcilable inconsistency between the bonds and the mortgage, the former will prevail.⁴ According to a recent Rhode Island case, a purchaser of bonds is not charged with notice of a want of authority in the treasurer to issue them without the concurrence of the president, although the treasurer's lack of authority was disclosed by the terms of the mortgage, the

¹ *Inhabitants of Anson*, 85 Me. 79; 26 Atl. 996.

² *Farmers' L. & T. Co. v. Chicago*, etc. R. R. Co., 68 Fed. 412.

³ *Taylor v. Atlantic*, etc. R. R. Co., 57 How. Pr. 26; *Stanton v. Alabama*, etc. R. R. Co., 2 Woods 523; *Grant v. Winona*, etc. Ry. Co., 89 N. W. 60; 85 Minn. 422. This principle has been carried to great lengths. Thus, where bonds are issued as "consolidated first mortgage bonds," the deed of trust stating that some of the consolidated bonds were to be

exchanged or substituted for old first mortgage bonds, it was held that purchasers of the new bonds were charged with notice of the existence of the old bonds, whose lien was superior to that of the new, and that therefore they could not maintain an action of deceit for misrepresenting the new bonds to be a first lien. *Caylus v. New York*, etc. R. R. Co., 10 Hun (N. Y.) 295.

⁴ *Supra*, § 1729.

bonds themselves reciting that they were issued in pursuance of authority from the shareholders, and being duly certified by the trustee.¹

§ 1846-§ 1847. *Nature of the Covering Deed of Trust.*

§ 1846. **Whether a "Mortgage."** — According to a popular American usage, a deed of trust to secure an issue of bonds is called a mortgage. Of course, the instrument is not in technical strictness, a legal mortgage, but may be more accurately described as a deed of trust in the nature of a mortgage. Whether or not the term "mortgage" in a statute, by-law, or other written instrument can apply to or include such a deed must depend largely upon the context and the intention to be gathered therefrom.² Thus, statutory authority of a corporation to mortgage its property will, according to the clear legislative intent, authorize a deed of trust in the nature of a mortgage.³ On the other hand, the English Court of Appeal differed in opinion as to whether such a deed was liable to stamp-duty as a mortgage.⁴ Mr. Justice Bradley held on circuit that, where a statute prescribed one method of acknowledgment for deeds and another for mortgages, a railway "mortgage" was properly acknowledged as a deed rather than as a mortgage.⁵ So a deed of trust to secure an issue of corporate bonds is not a mortgage within the meaning of a statute requiring a sale of land under a power contained in a mortgage to be made in the county in which the

¹ *Doty v. Oriental Print Works Co.* (R. I.), 67 Atl. 586.

² In addition to the cases cited below, see *Re Bondholders of York & Cumberland R. R. Co.*, 50 Me. 552; *Shaw v. Norfolk, etc. R. R. Co.*, 5 Gray (Mass.) 162, 180-182; *Southern Pac. R. R. Co. v. Doyle*, 11 Fed. 253; *Knickerbocker Trust Co. v. Penacook Mfg. Co.*, 100 Fed. 814 (applying a New Hampshire statute); *Illinois Trust, etc. Bank v. Seattle Electric Ry., etc. Co.*, 82 Fed. 936; 27 C. C. A. 268 (applying a Washington statute requiring affidavit of good faith to be attached to mortgages); *Bishop v. McKilligan*, 124 Cal. 321; 57 Pac. 76; 71

Am. St. Rep. 68 (statute as to execution of chattel mortgages applied to railway mortgage).

³ *Wright v. Bundy*, 11 Ind. 398, 404-405; *Pullan v. Cincinnati, etc. R. R. Co.*, 4 Biss. 35; *Carpenter v. Black Hawk Gold Mining Co.*, 65 N. Y. 43, 52-53.

Cf. *McLane v. Placerville, etc. R. R. Co.*, 66 Cal. 606, 612; 6 Pac. 748; *Coe v. Johnson*, 18 Ind. 218.

⁴ *City of London Brewery v. Inland Revenue Comm'rs* (1899), 1 Q. B. 121. Cf. *British Oil & Cake Mills v. Inland Revenue Comm'rs* (1903), 1 K. B. 689.

⁵ *Branch, Sons & Co. v. Atlantic, etc. R. R. Co.*, 3 Woods 481, 487.

land lies.¹ For somewhat different reasons, a statute requiring chattel mortgages to be recorded and providing that the charge should be valid for no more than two years from the time of recording has been held to have no application to a railway mortgage.²

§ 1847. **As a "Security" for a Debt, etc.** — Whether or not a deed of trust to secure an issue of corporation bonds can be deemed a mortgage, it is certainly a security for a debt. Hence, a statute providing that no sale made by a trustee under a deed limiting or conveying property as security for a debt shall pass any title unless the trustee before making the sale shall give bond for the faithful performance of the trust applies to sales made by the trustee under a power contained in a so-called corporation mortgage.³ So, an ordinary corporation mortgage is a "real estate security" within the meaning of an Iowa law authorizing the issue of bonds or debentures when "secured by an actual transfer of real estate securities" even in excess of a limit fixed for the other indebtedness of the corporation.⁴

§ 1848. **When the Charge takes Effect — Whether from the Execution of the Deed or from the Issue of the Bonds.** — It has

¹ *Harrison v. Annapolis, etc.* mortgage must be recorded as a
R. R. Co., 50 Md. 490. "mortgage of real estate").

² *Hammock v. Loan & Trust Co.*, As to the necessity of recording
105 U. S. 77. corporation mortgages, see also

Cf. Peoria, etc. R. R. Co. v. § 1686.
Thompson, 103 Ill. 187, 207-210; As to what will be, in the case of
Nichols v. Mase, 94 N. Y. 160; a deed of trust to secure bonds, a
Palmer v. Forbes, 23 Ill. 301; sufficient compliance with a statute
Farmers' L. & T. Co. v. Detroit, etc. requiring an affidavit to be annexed
R. R. Co., 71 Fed. 29; *Craft v. Indi-* to mortgages stating the considera-
ana, etc. Ry. Co., 166 Ill. 580; 46 tion, etc., see *Camden Safe Deposit*
N. E. 1132. *Co. v. Burlington Carpet Co.*, 33

But see *Union, etc. Trust Co. v.* Atl. Rep. 479 (N. J. Ch.).
Southern Cal., etc. Co., 51 Fed. 840, As to the effect upon corporation
850-851; *Manhattan Trust Co. v.* mortgages of a statute forbidding
Seattle Coal & Iron Co., 48 Pac. 333; mortgages to secure future advances,
16 Wash. 499; *Williamson v. New* see *Richards v. Merrimack, etc. R. R.*
Jersey Southern R. R. Co., 29 N. J. *Co.*, 44 N. H. 127.

Eq. 311; *Benedict v. St. Joseph, etc.* ³ *Union Trust Co. v. Ward*, 100
R. R. Co., 19 Fed. 173; *Harriman* Md. 98; 59 Atl. 192.

v. Woburn Electric Light Co., 163 ⁴ *First Nat. Bank v. Sioux City*
Mass. 85 (holding that a corporation *Terminal, etc. Co.*, 69 Fed. 441.

been said that when the execution of the deed of trust precedes the issue of the bonds, the lien of the mortgage dates not from the execution of the deed of trust, but from the issue of the bonds,¹ and it is doubtless true that until some at least of the bonds are issued the company retains power to create a paramount lien upon the property, so that a person taking the bonds with notice of the subsequent encumbrance would be postponed thereto. Consequently, where no bonds are ever issued, the mortgage never takes effect, and therefore a sale by the trustee under a power contained in the mortgage passes no title.² Moreover, until some of the bonds are issued, the trustee is a mere agent of the company, and he both may and should obey its directions.³

On the other hand, a holder of bonds for value without notice of a lien created after the execution of the covering deed of trust but before the issue of the bonds will have priority,⁴ but the rule is different where the bondholder takes with notice of the lien.⁵ So, where bonds are issued fraudulently by an officer of the company while the mortgaged property is under the control of a court of equity, the doctrine of *lis pendens* does not invalidate the title of a *bona fide* holder of those bonds; for the title of such a holder, although acquired during the pendency of the equity suit, nevertheless relates back to the execution of the covering deed of trust or mortgage.⁶ Not altogether easy to reconcile with

¹ *Wade v. Donau Brewing Co.,coln Street Ry. Co.*, 93 N. W. 766; 10 Wash. 284; 38 Pac. 1009. Cf. 67 Nebr. 469.

Allen v. Montgomery R. R. Co., 11 Ala. 437, 452-453; *I. C. Johnson & Co.* (1902), 2 Ch. 101 (stated *infra*); *Harrogate Estates* (1903), 1 Ch. 498.

² *Scott v. Farmers', etc. Nat. Bank*, 75 S. W. 7, 9; 97 Tex. 31.

³ *Peninsular Iron Co. v. Eells*, 68 Fed. 24.

⁴ *Central Trust Co. v. Continental Iron Works*, 51 N. J. Eq. 605; 28 Atl. 595; 40 Am. St. Rep. 539.

Cf. *Reed's Appeal*, 122 Pa. St. 565; 16 Atl. 100; *Central Trust Co. v. Louisville, etc. Ry. Co.*, 70 Fed. 282; *City of Lincoln v. Lin-*

As to the rights of holders of first-mortgage bonds issued after execution of second-mortgage and issue of second-mortgage bonds, see *infra*, § 1896.

⁵ *Porch v. Agnew Co.* (N. J. Ch.), 61 Atl. 721.

Cf. *International Trust Co. v. Davis, etc. Mfg. Co.*, 46 Atl. 1054; 70 N. H. 118 (holding that an attachment takes precedence over bonds previously issued, but not over bonds of the same series subsequently issued).

⁶ *Pittsburgh, etc. Ry. Co. v. Long Island, etc. Trust Co.*, 172 U. S. 493, 513-515 (headnote inadequate); 19 Sup. Ct. 238.

these cases is an English decision to the effect that a statute requiring registration of charges created after the passage of the act applies to debentures issued after the act, although the covering deed of mortgage by which they were secured had been executed, and some of the bonds of the same series, all of which were to rank *pari passu*, had been issued, before the act went into effect.¹ Where the mortgage deed covers bonds which were issued in exchange for bonds of a prior issue, it has been held that the lien of the trustee for holders of the bonds so issued in exchange dates from the original deed of trust which secured the exchanged bonds, so that the bondholders cannot be prejudiced by a decree in a suit commenced against the company after the original but before the last deed of trust.²

If some only of the series of bonds intended to be secured by a mortgage deed of trust are issued, the holders of the bonds so issued are entitled to the entire benefit of the mortgaged property as if no other bonds had been contemplated, so that they are entitled to payment in full out of the proceeds of sale of the mortgaged property, if sufficient for that purpose, and not merely to the proportion thereof that the number of bonds actually issued bears to the total number originally intended to be issued.³

§ 1849. **What Bonds are secured by the Deed.** — Usually no difficulty is experienced in identifying the bonds which the deed of trust is intended to secure. Indeed, the common and commendable practice is to set out in the deed of trust a full recital of the bonds. Trouble may arise where a less careful course is pursued. When bonds correspond with the recital in the deed of trust, the fact that they are the bonds intended to be secured thereby is sufficiently established although the date of the bonds is prior to the date of the deed, especially when parol evidence shows that no other bonds were issued by the company.⁴ The difficult questions which arise in a case of overissue of bonds — that is to say, in case of the issue of more bonds than are contemplated by the deed of trust — are considered below.⁵

¹ *I. C. Johnson & Co. (1902), ciple, International Trust Co. v. Davis, etc. Mfg. Co., 46 Atl. 1054; 2 Ch. 101.*

Cf. S. Abrahams & Sons (1902), 70 N. H. 118.
¹ *Ch. 695, 697-698.*

² *Farmers' L. & T. Co. v. Meridian Waterworks Co., 139 Fed. 661.*

Another illustration of same prin-

³ *Infra, § 1886.*

⁴ *Butler v. Rahm, 46 Md. 541, 545-546.*

⁵ *Infra, § 1888.*

§ 1850-§ 1851. *Charge or Security not created by a formal Deed.*

§ 1850. **Bonds which themselves operate to create a Charge or Mortgage.** — If bonds issued by a company pledge its property for the payment of the debt, they will be treated by a court of equity, except so far as statutory obstacles in shape of recording acts, and the like, may prevent, as themselves equivalent to a mortgage.¹ Indeed, attention has been already called to the fact that English debentures very often themselves create the mortgage or charge by which they are secured,² thus combining the functions of the ordinary American bonds and the mortgage deed of trust.

§ 1851. **What Words are sufficient to create a Charge or Lien.** — The intention to create some sort of charge or lien — that is to say, to give the bondholders the rights of secured as distinguished from unsecured creditors — cannot often in the United States be a matter of dispute. The execution of a formal deed with that very object leaves no room for question. The fact that a very long period is to elapse before bonds or debentures are to mature tends to show that some sort of security was intended; for it is unlikely that a creditor would bind himself not to sue for a long period without taking some security.

A clause in the bonds that all of the same issue shall rank *pari passu* is almost irresistible evidence of an intent to create a charge or security; for otherwise the provision would be meaningless. Hence, where a corporation by the terms of certain debentures bound itself and its successors and its “real and personal estate,” and declared that all the debentures of the series should rank *pari passu*, the Court held that a “floating charge” on all the company’s property, present and future, was created.³

If the corporation designates some fund, such as its future

¹ *White Water Valley Co. v. etc. R. R. Co.*, 16 Fed. 804 (headnote Vallette, 21 How. 414; *King v. inadequate*).

Tuscumbia R. R. Co., 7 Pa. L. J. ² *Supra*, § 1685.

166; *Howard v. Iron & Land Co.*, ³ *Ex parte Bradshaw*, 15 Ch. D. 62 Minn. 298; 64 N. W. 896; 465.

Hamilton Trust Co. v. Clemes, 163 N. Y. 423; 57 N. E. 614 (where a mortgage was executed, but omitted some statutory formalities). Cf. *Florence Land, etc. Co.*, 10 Ch. D. 530.

But see *Riggs v. Pennsylvania*,

earnings, for the payment of certain indebtedness, the court may conclude, especially if from attending circumstances a lending without security appears very unlikely, that a lien upon that fund was created.¹ On the other hand, where a statute provided that the bond creditors of a railway corporation should be paid out of the tolls and other estate and effects of the company, the court held that the language referred to was intended to draw a distinction between the mortgage creditors, who were entitled to be paid out of certain specific assets and the bond creditors who could look to any of the company's property, and that therefore the bond creditors had no lien or charge on any property;² but this case was decided before the modern law of railway bonds or debentures had been worked out.

A clause in a traffic arrangement between two railway companies providing that the contract and any damages for a breach thereof shall be a "continuing lien upon the roads of the two contracting companies, their equipment and income, in whose-soever hands they may come" has been held to create no lien which could outrank a subsequent mortgage;³ but, save for the high authority by which this decision was rendered, one might well question whether the reasons assigned therefor are wholly satisfactory.

It would seem clear that a mere agreement by a consolidated corporation to "protect" the debts of one of the constituent companies creates no lien, and this conclusion is supported by a decision of the Supreme Court of the United States;⁴ but on the other hand the Supreme Court of Ohio has taken the contrary view.⁵ The mere fact that the statute under which the bonds are issued declares that they "shall be binding on the property of said company and on such other property belonging to the stockholders as they shall pledge to said company," etc., is not sufficient to create any lien or charge.⁶

¹ *Ketchum v. St. Louis*, 101 U. S. 306.

But see *Thomas v. New York, etc. Ry. Co.*, 139 N. Y. 163; 34 N. E. 877.

² *Russell v. East Anglian Ry. Co.*, 3 Mac. & G. 124.

³ *Des Moines, etc. R. R. Co. v. Wabash, etc. Ry. Co.*, 135 U. S. 576; 10 Sup. Ct. 753.

⁴ *Wabash, etc. Ry. Co. v. Ham*, 114 U. S. 587, 596; 5 Sup. Ct. 1081.

⁵ *Compton v. Railway Co.*, 45 Oh. St. 592.

⁶ *Brunswick, etc. R. R. Co. v. Hughes*, 52 Ga. 557.

But see *State v. Florida Central R. R. Co.*, 15 Fla. 690.

§ 1852-§ 1884. *WHAT PROPERTY IS COVERED BY THE LIEN OR CHARGE.*

§ 1852. **Sufficiency of general Description of Property charged.** — If it be conceded or established that a charge or lien has been created or intended to be created in favor of bonds or debentures, the next question is how far that charge extends and what property and rights it covers. Usually, the intention is to secure the bonds by a charge of all the company's property. Ordinarily there is, and should be, no legal objection to such a charge.¹ But by some troublesome and mistaken statutes, a charge or mortgage will not be effective against the general creditors of the debtor company, if the company remain in possession of the property, unless a particular description of the property be given in the mortgage or deed of trust; and under such statutes a mortgage deed of trust covering all the machinery, tools, etc. of the company in a particular locality is insufficient.² Where such a statute is in force, the appointment of a receiver for the benefit of the bondholders is not deemed such a taking of possession by the mortgagee as to give validity to their charge.³

§ 1853-§ 1868. AFTER-ACQUIRED PROPERTY.

§ 1853-§ 1858. *Validity of Charge of After-acquired Property.*

§ 1853. **In general.** — A charge of the comprehensive nature of that which secures an issue of bonds amounting, perhaps, to many millions of dollars would be of comparatively little worth if it covered only property that belonged to the company at the time. Indeed, bonds are often issued and mortgages created immediately upon the incorporation of the company when it owns little or no property. Accordingly, some expedient by which after-acquired property shall be subjected to the charge

¹ Cf. *Union Trust Co. v. Mercantile Library Hall Co.*, 189 Pa. St. 263; 42 Atl. 129 (holding that the mortgagor company will not be heard to object that the description of the mortgaged property is too indefinite).

² *Central Trust Co. v. Worcester Cycle Mfg. Co.*, 93 Fed. 712; 35 C. A. 547.

³ *Central Trust Co. v. Worcester Cycle Mfg. Co.*, 93 Fed. 712; 35 C. C. A. 547. Cf. *infra*, § 1878.

is indispensable.¹ Of course, a conveyance cannot pass the legal title to property which the grantor does not then own but which he afterwards acquires.² If the property granted is specifically described, the conveyance may possibly operate by way of estoppel so as to vest the legal title in the grantee; but where the conveyance is in general terms, as, "all my property present and future," there would seem to be no basis for an estoppel.

§ 1854. **American Cases sustaining charges of After-acquired Property.** — The American courts were early driven, by commercial necessity, to hold that a mortgage of a railroad, covering rolling stock, machinery, etc., was operative upon after-acquired property. Some courts sought to justify this conclusion upon the ground that rolling stock, etc., were fixtures.³ Others took the similar ground that the railroad and all that might be necessary to operate it should be regarded as an entirety.⁴ Such notions, however, seem fanciful. They would be of no assistance when similar bonds and mortgages are issued by other kinds of corporations than railway companies. Moreover, they were the offspring of a shrinking from the real question. Accordingly, the American courts in general have now courageously laid the spectre, and held that conveyances of after-acquired property by way of mortgage or charge to secure an issue of bonds are effective in equity. In the earliest case upon the subject in the Supreme Court of the United States, the validity of such a charge in equity was upheld as applied to any case where the property to be charged was described in some comparatively definite way — for example, where the charge covered the engines then owned or to be thereafter acquired by the company; but a doubt was intimated whether a general charge of all the company's present and future property could be sustained even in equity.⁵ This doubt, however, has never since come to the surface in that court.⁶

¹ See the well-reasoned judgment in *Metropolitan Trust Co. v. Dolgeville Electric, etc. Co.*, 35 N. Y. Misc. 467; 71 N. Y. Supp. 1055.

² *Spinney v. Meloon* (N. H.), 68 Atl. 410.

³ *Palmer v. Forbes*, 23 Ill. 301.

⁴ *Morrill v. Noyes*, 56 Me. 458; 96 Am. Dec. 486; *Pierce v. Emery*, 32 N. H. 484.

⁵ *Pennock v. Coe*, 23 How. 117.

⁶ Cf. *Parker v. New Orleans, etc. R. R. Co.*, 33 Fed. 693; *Buck v. Seymour*, 46 Conn. 156, 172-173.

But see *Mississippi Valley Co. v. Chicago, etc. Co.*, 58 Miss. 896, 903-904; 38 Am. Rep. 348; *Borden v. Crook*, 131 Ill. 68; 22 N. E. 793; 19 Am. St. Rep. 23; *Calhoun v.*

§ 1855. **English Cases.** — In England, the validity of a charge upon after-acquired property, after some early doubts, has been even more thoroughly vindicated than in America. Thus, a bill of sale of all the grantor's book-debts is good in equity although not confined to book-debts in any particular business,

Memphis, etc. R. R. Co., 2 Flippin 442, 449.

For cases supporting the validity of charges of after-acquired property, see among others, *Dunham v. Cincinnati, etc. Ry. Co.*, 1 Wall. 254, 266-267; *Nichols v. Mase*, 94 N. Y. 160; *Clay v. East Tennessee, etc. R. R. Co.*, 6 Heisk (Tenn.) 421; *Philadelphia, etc. R. R. Co. v. Woelpper*, 64 Pa. St. 366; 3 Am. Rep. 596; *Willink v. Morris Canal, etc. Co.*, 4 N. J. Eq. 377, 402-403; *Williamson v. New Jersey Southern R. R. Co.*, 25 N. J. Eq. 13; *Little Rock, etc. Ry. Co. v. Page*, 35 Ark. 304; *Barnard v. Norwich, etc. R. R. Co.*, 4 Cliff. 351; *Scott v. Clinton, etc. R. R. Co.*, 6 Biss. 529; *City of Quincy v. Burlington, etc. R. R. Co.*, 94 Ill. 537; *Coopers & Clark v. Wolf*, 15 Oh. St. 523; *Jessup v. Bridge*, 11 Iowa 572; 79 Am. Dec. 513; *Butler v. Rahm*, 46 Md. 541; *Pere Marquette R. R. Co. v. Graham*, 99 N. W. 408; 136 Mich. 444; *St. Joseph, etc. Ry. Co. v. Smith (Mo.)*, 170 Mo. 327; 70 S. W. 700; *Flanagan Bank v. Graham*, 71 Pac. 137, 790; 42 Oreg. 403; *Central Trust Co. v. Washington County R. R. Co.*, 124 Fed. 813; *Washington Trust Co. v. Morse Iron Works*, 106 N. Y. App. Div. 195; 94 N. Y. Supp. 495; *Venner v. Farmers' L. & T. Co.*, 90 Fed. 348; 33 C. C. A. 95; *Allen v. Windham, etc. Mfg. Co.*, 87 Fed. 786 (charge valid when possession taken by mortgagee); *Beach v. Wakefield*, 107 Iowa 567, 583; 76 N. W. 688; 78 N. W. 197 (semble); *People's Trust Co. v. Schenck*, 106 N. Y. Supp. 782; 121 N. Y. App. Div. 604 (a railway company); *J. F. White Co. v. Carroll (N. Car.)*, 59 S. E. 678 (mortgage of stock in

trade by individual trader); *Lamar Land, etc. Co. v. Belknap Sav. Bank*, 64 Pac. 210; 28 Colo. 344.

But see *Beebe v. Richmond Power Co.*, 13 N. Y. Misc. 737; 35 N. Y. Supp. 1; *Rochester Distilling Co. v. Rasey*, 142 N. Y. 570; 37 N. E. 632; 40 Am. St. Rep. 635; *Hunt v. Bullock*, 23 Ill. 320, 324-325; *Stevens v. Watson*, 4 Abb. Ct. App. Dec. (N. Y.) 302; *Titus v. Mabey*, 25 Ill. 257; *Emerson v. European, etc. Ry. Co.*, 67 Me. 387; 24 Am. Rep. 39; *Georgia, etc. Ry. Co. v. Barton*, 28 S. E. 842; 101 Ga. 466; *Zartman v. First Nat. Bank*, 82 N. E. 127; 189 N. Y. 267; *Harriman v. Woburn Electric Light Co.*, 163 Mass. 85 (holding that the mortgage does not become operative until the mortgagee takes possession).

Cf. *Coe v. Columbus, etc. R. R. Co.*, 10 Oh. St. 372; 75 Am. Dec. 518; *Dinsmore v. Racine, etc. R. R. Co.*, 12 Wisc. 649; *Farmers' L. & T. Co. v. Commercial Bank*, 11 Wisc. 207.

In some cases the power to charge after-acquired property has been rested upon enabling statutes. *Phillips v. Winslow*, 18 B. Monr. (Ky.) 431; 68 Am. Dec. 729; *Bell v. Chicago, etc. R. R. Co.*, 34 La. Ann. 785; *Seymour v. Canandaigua, etc. R. R. Co.*, 25 Barb. 284, 308; *Georgia Southern, etc. R. R. Co. v. Mercantile Trust, etc. Co.*, 94 Ga. 306; 21 S. E. 701; 47 Am. St. Rep. 153; 32 L. R. A. 208 (where the company was held entitled to the privileges conferred by the enabling act although it was a corporation *de facto* merely); *Central Trust Co. v. Chattanooga, etc. R. Co.*, 94 Fed. 275; 36 C. C. A. 241 (applying Georgia law).

and will operate upon book-debts subsequently contracted.¹ An objection on the score of vagueness was brushed aside by the House of Lords. And the courts on that side of the Atlantic have not lent a willing ear to objections based on statutes the purpose of which did not require the striking down of such charges.²

§ 1856. **Distinction between an Individual and a Corporation in respect to general Charge of After-acquired Property.** — A distinction should be observed between the policy of the law applicable to general charges of after-acquired property by individuals and that applicable to similar charges by corporations. For in the case of an individual, a general charge of all the property which he may subsequently acquire might well enough be held contrary to public policy and void, being in the nature of a mortgage of the person and reducing the individual to a state of virtual villeinage.³ But in the case of a corporation or artificial person, no such considerations are applicable.

Moreover, in the case of an individual, a mortgage of after-acquired chattels with a clause permitting the mortgagor to retain possession and sell off goods from time to time and pocket the proceeds may well enough be deemed constructively fraudulent as against creditors, because the power is reserved for the benefit of the mortgagor.⁴ But in the case of a corporation, if the mortgage covers all the property, business, and undertaking, such a power, as it enables the business to be kept alive, enures to the benefit of the mortgagee. Hence, there is not the same reason for holding the mortgage inoperative.⁵

§ 1857. **Cases which throw Doubt on Validity of Charges of After-acquired Property created by Corporations not engaged in Public Service.** — Some unfortunate cases, happily in a minority,⁶

¹ *Tailby v. Official Receiver*, 13 A. C. 523. For other cases in the United Kingdom sustaining charges of after-acquired property, see *Bloomer v. Union Coal, etc. Co.*, 16 Eq. 383; *Anderson v. Butler's Wharf Co.*, 48 L. J. Ch. 824; *Dublin Drapery Co.*, 13 L. R. Ir. 174.

² *Dublin Drapery Co.*, 13 L. R. Ir. 174. Cf. *Florence Land, etc. Co.*, 10 Ch. D. 530.

³ *Baltimore Humane Impartial*

Soc. v. Pierce, 100 Md. 520; 60 Atl. 277; 108 Am. St. Rep. 450; 70 L. R. A. 485.

⁴ Cf. *Blanchard v. Cooke*, 144 Mass. 207.

⁵ See *infra*, § 1927.

⁶ See *Washington Trust Company v. Morse Iron Works*, 106 N. Y. App. Div. 195; 94 N. Y. Supp. 495; *Old Colony Trust Co. v. Standard Beet Sugar Co.*, 150 Fed. 677 (semble); *U. S. Mortgage, etc. Co.*

throw doubt upon the validity of charges upon after-acquired property created by other than public service corporations.¹ It is argued that the validity of such charges in the case of railway companies depends upon "the necessity or public policy of holding together the whole of a railroad or system of railroads and other quasi-public properties." But it is submitted that if it be necessary to search outside of the general doctrines of equity for a principle of public policy upon which to support the validity of charges on after-acquired property in corporation mortgages, that principle will be found in the desirability of enabling corporations to issue a convenient security in the shape of mortgage bonds, secured by a charge upon all the property of the company, present and future, and by such issue to promote enterprise and commercial activity without injustice to any one. Such considerations apply with as much force to industrial corporations as to railway corporations.² In England, as we have seen above, debentures charged upon a company's entire property and estate present and future have been often sustained by the courts, and have been in common use for many years. They have been found beneficial to everyone, and by no means unjust to the general creditors.³ On the

v. *Eastern Iron Co.*, 105 N. Y. Supp. 291.

See also cases cited *infra*, note 2, and *supra*, § 1854.

¹ *Adamant Plaster Co.*, 137 Fed. 251, 255-256; *Marine Construction, etc. Co.*, 144 Fed. 649; 75 C. C. A. 451 (purporting to apply the law of New York); *Zartman v. First Nat. Bank*, 82 N. E. 127; 189 N. E. 267 (as to the shifting stock in trade of a manufacturing company).

² *Metropolitan Trust Co. v. Dolgeville Electric, etc. Co.*, 35 N. Y. Misc. 467; 71 N. Y. Supp. 1055; *New York Security Co. v. Saratoga Gas Co.*, 88 Hun 569, 588-590; 34 N. Y. Supp. 890, affirmed on opinion below in 157 N. Y. 689; 51 N. E. 1092.

³ Cf., however, remarks of Buckley, J., in *London Pressed Hinge Co.* (1905), 1 Ch. 576, commented upon *supra*, p. 1393. n. 2. The New York

Court of Appeals has recently said,

"If it is understood that a corporate mortgage given by a manufacturing corporation may take everything except accounts and debts, such corporations, with a mortgage outstanding, will have to do business on a cash basis or cease to do business altogether." *Zartman v. First Nat. Bank*, 82 N. E. 127, 128; 189 N. Y. 267. It is submitted that the mortgage bondholders should be allowed to take everything including accounts and debts, and that the power to create such mortgages will be very beneficial to the corporations, as is demonstrated by the popularity of floating charges in England. Credit is given in commercial transactions not because the creditor expects to avoid total loss in case of the debtor's bankruptcy — if he contemplates the likelihood of bankruptcy he will either refuse

contrary, by enabling a struggling enterprise to secure the funds necessary for its success, they often subserve the interests of the general creditors. The requirement of registration prevents any possible injustice to general creditors and junior encumbrancers. Can it be that the people of America are to be deprived of the benefit of such securities in the case of industrial corporations because of a lack of business sense and foresight on the part of the judges? The student of the law, upon reading the unfortunate expressions of judicial opinion referred to at the beginning of this paragraph can but wish for a return to earth of the spirit of Lord Mansfield and Chief Justice Marshall.

§ 1858. **Recent theoretical Objections to Validity of Charges of After-acquired Property.** — Professor Williston in a recent careful article suggests numerous objections, based upon recording acts, bankrupt laws, etc., against the validity of charges upon “future goods” or after-acquired property;¹ but the learned author admits that the difficulties which he suggests have little or no application in reason to corporate bonds and debentures, and he intimates that a statute might well be passed to exempt such securities from the application of the various rules of law which he is considering. It is submitted that a judge animated by the spirit of commercial law should not hesitate without the aid of any statute to make such exemption, if indeed exemption from general rules be necessary in order to sustain charges of after-acquired property securing a series of corporation bonds or debentures.

§ 1859. **Nature of Charge of After-acquired Property — Not a mere Contract but a present equitable Charge.** — It is sometimes said that a charge of after-acquired property is effective

to give credit or insist upon sufficient collateral — but because he expects the debtor's enterprise to be successful. Anything that tends to promote the success of the enterprise is beneficial to the general creditors.

jections founded on the Bankrupt Law, see *Humphrey v. Tatman*, 198 U. S. 91; 25 Sup. Ct. 567; *Thompson v. Fairbanks*, 196 U. S. 516; 25 Sup. Ct. 306; *Zartman v. First Nat. Bank*, 82 N. E. 127; 189 N. Y. 267.

¹ 19 Harv. L. Rev. As to ob-

as a contract to execute a mortgage thereof and as such contract will be specifically enforced at least as to real property.¹ But it is submitted that the true operation of the charge is hardly expressed adequately in that way. The charge at law is at most a contract to mortgage after-acquired property, but in equity it fastens itself upon the property as soon as acquired, as a present equitable charge.

§ 1860. **Necessity that Intent to charge After-acquired Property should affirmatively appear.**—The intention to charge after-acquired property must affirmatively appear.² Thus, where a corporation mortgage a certain parcel of land with the improvements, machinery, fixtures, etc., “and other property generally thereon or elsewhere erected or located, the whole constituting the plant of the said mortgagor,” a federal judge held that no intention to charge after-acquired property was manifested.³

§ 1861-§ 1868. *What passes under After-Acquired Property Clause.*

§ 1861. **Liberal Construction of Clause.**—The inclination of some courts is — and properly enough — rather to favor than discountenance charges of after-acquired property,⁴ and they will be carried out not merely in letter but in spirit. Thus, where a railway company mortgaged its railroad, constructed and to be constructed, with all rights of way acquired or to be acquired, the court held that the charge included a completed road which was bought by the mortgagor company, as fully as if it had been constructed with its own funds.⁵

§ 1862. **Equitable Interests.**—Since a charge of after-

¹ Cf. *Grape Creek Coal Co. v. Mfg. Co.*, 77 Fed. 938. To substantially the same effect: *Louisville Trust Co. v. Cincinnati Inclined-Plane Ry. Co.*, 91 Fed. 699.

Farmers' L. & T. Co., 63 Fed. 891; 12 C. C. A. 350; *Price v. Morning Star Mining Co.*, 83 Mo. App. 470; *Fidelity Trust Co. v. Staten Island Clay Co.* (N. J. Ch.), 67 Atl. 1078.

⁴ *Little Rock, etc. Ry. Co. v. Page*, 35 Ark. 304.

² Cf. *New Clydach Sheet & Bar Iron Co.*, 6 Eq. 514. *Quare*, whether this case can be supported to its full extent. See *infra*, p. 1519, n. 2.

⁵ *Branch v. Jesup*, 106 U. S. 468, 485-486; 1 Sup. Ct. 495. Cf. *Columbia, etc. Trust Co. v. Kentucky Union Ry. Co.*, 60 Fed. 794 (head-note inadequate); 9 C. C. A. 264.

³ *Maxwell v. Wilmington Dental*

acquired property will be made operative in equity upon after-acquired legal estates, *a fortiori* equitable interests will pass.¹

§ 1863. **Contracts executed by the Company after Issue of the Bonds.** — It has been held that a contract between the mortgagor company and another company by which the latter agrees to pay the accruing interest on the bonds of the former will not pass under an after-acquired property clause in a deed of trust to secure an issue of bonds, and therefore will not enure to the benefit of the holders of those bonds.² It is, however, difficult to see why a contract should not be deemed property within the meaning of an after-acquired property clause.

§ 1864. **Property acquired after Date of Deed but before its actual Execution.** — Where the deed of trust is antedated, the after-acquired property clause will cover property acquired after the date of the deed but before its execution.³

§ 1865. **Property of another Corporation with which the mortgagor Company is consolidated.** — Where two corporations are consolidated or amalgamated, the property of neither will pass as after-acquired property of the other under a mortgage previously executed by the other to secure an issue of its bonds.⁴ Under such circumstances neither of the companies acquires the property of the other.

§ 1866. **Property acquired by consolidated Corporation after Absorption of mortgagor Company.** — But it may be a nice question whether the after-acquired property clause will have the effect of subjecting to the lien of the mortgage, property that is

¹ *Toledo, etc. R. R. Co. v. Hamilton*, 134 U. S. 296; 10 Sup. Ct. 546; *Central Trust Co. v. Kneeland*, 138 U. S. 414; 11 Sup. Ct. 357; *Wade v. Chicago, etc. R. R. Co.*, 149 U. S. 327; 13 Sup. Ct. 892; *Brady v. Johnson*, 75 Md. 445, 454-455; 26 Atl. 49; 20 L. R. A. 737; *Columbus, etc. R. R. Co. Appeals*, 109 Fed. 177, 205 et seq.; 48 C. C. A. 275 (where a mortgagee from the holder of the legal title was affected with notice of the equitable rights of the company, and of the holders of the previously issued bonds, by the open and notorious possession of the property by the company).

Cf. Guaranty Trust Co. v. Atlantic Coast Electric R. R. Co., 138 Fed. 517; 71 C. C. A. 41. See also *infra*, § 1909.

² *Moran v. Pittsburgh, etc. Ry. Co.*, 32 Fed. 878. *Quare*, whether the bondholders can have the benefit of such a contract in any jurisdiction where the doctrine of *Lawrence v. Fox*, 20 N. Y. 268, is accepted.

³ *Guaranty Trust Co. v. Atlantic Coast Electric R. R. Co.*, 138 Fed. 517; 71 C. C. A. 41.

⁴ *Gibert v. Washington City, etc. R. R. Co.*, 33 Gratt. (Va.) 586, 603-609 (headnote inadequate).

acquired by a consolidated corporation into which the original company has been amalgamated or merged.¹ Much would depend on the terms of the statute under which the consolidation takes place.²

§ 1867. **Property acquired under Statute enlarging Company's Powers.** — Whether property which is acquired by the company for an extension of its business under a legislative act amending and extending its powers will pass under a previous mortgage executed to secure an issue of bonds is a question not entirely free from difficulty. The question must be determined partly from the language used in the mortgage deed of trust. For unless the language is broad enough to cover the property acquired under the amendatory act, of course that property cannot pass. On the other hand, even if the language of the mortgage be sufficiently broad, the property will not be included in the charge if the court can gather from the act of the legislature an intention that it should not do so.³ The tendency is to hold that the previous charge does not cover such property.⁴ Where, however, the amendatory act does not substantially alter the objects of the incorporation — for example, where an amendatory statute alters slightly the course over which a railway company is authorized to construct its line, or merely changes the name of the company — the inclination is to hold that property acquired by virtue of such an act passes under a previous mortgage securing an issue of bonds.⁵

§ 1868. **Property acquired by Receiver or Liquidator.** — Property acquired by the receiver or liquidator of a corporation is not subject to the lien of an after-acquired property clause in a deed securing a prior issue of bonds. Upon this principle, it has been

¹ See *Hamlin v. Jerrard*, 72 Me. 62; *New York Security, etc. Co. v. Louisville, etc. R. Co.*, 102 Fed. 382, 398.

Cf. Hinchman v. Point Defiance Ry. Co., 14 Wash. 349, 364; 44 Pac. 867; *Fidelity Trust Co. v. Staten Island Trust Co.* (N. J. Ch.), 67 Atl. 1078 (property acquired by a company purchasing the property of mortgagor company held not to pass).

² *Cf. Polhemus v. Fitchburg R.*

Co., 123 N. Y. 502; 26 N. E. 31.

³ *Cf. Randolph v. Wilmington, etc. R. R. Co.*, 11 Phila. 502 (U. S. Circ. Ct.).

⁴ *Alexandria, etc. Ry. Co.'s Trustee v. Graham*, 31 Gratt. (Va.) 769; *Meyer v. Johnson*, 53 Ala. 237; s. c., 64 Ala. 603.

⁵ *Meyer v. Johnson*, 53 Ala. 237, 328-330, 356-360; 64 Ala. 603. *Cf. Elwell v. Grand Street, etc. R. R. Co.*, 67 Barb. (N. Y.) 83.

held that where property is purchased by the company with a proviso that no title shall pass from the vendor until the payment of the purchase money in full, and the payment is not completed until after the company has gone into liquidation, the property in question is not subject to the lien securing a prior issue of bonds.¹

§ 1869—§ 1871. *Whether the Charge covers all or only some of the Company's Property.*

§ 1869. **In general.**—Often the charge does not cover all the company's property but is confined to certain specified kinds of property. For instance, a railway company mortgages its road, constructed and to be constructed, and all property appurtenant thereto which the company then owns or may thereafter acquire. Such a charge does not cover lands subsequently granted to the corporation by Congress to aid in the construction of its road,² nor shares in an elevator company which the railway subsequently acquired.³ A charge upon the premises of the company and its plant, machinery, and effects in and upon the same or used in connection therewith, covers the company's

¹ *Tilford v. Atlantic Match Co.*, 134 Fed. 924. (*Quære*, whether the company had not acquired an equitable title prior to the receivership). Cf. *infra*, § 1875.

² *New Orleans Pac. Ry. Co. v. Parker*, 143 U. S. 42; 12 Sup. Ct. 364.

³ *Humphreys v. McKissock*, 140 U. S. 304; 11 Sup. Ct. 779. A detailed consideration of what will pass and what will not pass as appurtenant to a railroad is beyond the scope of this work. See Short's *Law of Railway Bonds*, § 231. Cf. *Morgan v. Donovan*, 58 Ala. 241; *Hamlin v. European, etc. Ry. Co.*, 72 Me. 83; *Raymond v. Clark*, 46 Conn. 129; *Buck v. Seymour*, 46 Conn. 156; *Parish v. Wheeler*, 22 N. Y. 494; *State v. Northern Central Ry. Co.*, 18 Md. 193, 217-218; *Morgan County v. Thomas*, 76 Ill. 121; *Farmers' L. & T. Co. v. San*

Diego, etc. Co., 49 Fed. 188, 196; *Pardee v. Aldridge*, 189 U. S. 429; 23 Sup. Ct. 514, affirming *Aldridge v. Pardee*, 60 S. W. 789; 24 Tex. Civ. App. 254; *Chicago, etc. Ry. Co. v. Tice* (Ill.), 83 N. E. 818 (holding that an undivided interest in after-acquired property cannot be appurtenant to a railway).

As to what will and what will not pass under a mortgage of a railway and property "connected therewith," see *Guaranty Trust Co. v. Atlantic Coast Electric R. R. Co.*, 138 Fed. 517; 71 C. C. A. 41; *Chicago, etc. Ry. Co. v. McGuire* (Ind.), 65 N. E. 932; *Murray v. Farmville, etc. R. R. Co.*, 43 S. E. 553; 101 Va. 262; *People's Trust Co. v. Schenck*, 106 N. Y. Supp. 782; 121 N. Y. App. Div. 604 (after-acquired land under water held to pass).

stock in trade but not its book-debts.¹ On the other hand, the charge may include all property and rights of every kind and description. A lien upon a railway company's "road and property" will cover any kind of property, and therefore will include surplus lands donated to the company by a grant from the state,² or shares of capital in another corporation.³

§ 1870. **Restraining general Words by Context.** — Even, however, words which taken by themselves are of the utmost generality may be limited by the context and by the application of the *eiusdem generis* rule.⁴ Thus, where a railway mortgage described the property charged as "all the present and in future to be acquired property of or in any manner appertaining to the Linneus Branch of the Burlington and Southern Railway Company . . . that is to say" followed by an enumeration of certain kinds of property and not mentioning municipal bonds, the court held that the generality of the word "property" was confined by the phrase "that is to say" to the particular kinds of property mentioned, and that consequently municipal bonds presented to the company to aid in the construction of the Linneus Branch could not pass.⁵ So, when a mortgage given by a railroad company "upon the lands granted by the United States to said Railroad Company . . . also the telegraph line and telegraph offices along the line of said road, and belonging to said company; also the machine shops and *all other property* in said States of Alabama, Georgia, Tennessee and Mississippi belonging to said company, and all other mineral lands and all iron manufacturing establishments now in operation and hereafter to be constructed," the court was obliged to hold that the general words which are printed in italics, and which were "found neither in the beginning as a general phrase to the emphasis of a more minute description, nor at the end, as a summary of what had preceded them" were confined in their

¹ *Anglo-American Leather Cloth Co.*, 43 L. T. 43.

Cf. *Buvinger v. Evening Union Printing Co.* (N. J.), 65 Atl. 482, stated *infra*, § 1871.

² *Wilson v. Boyce*, 92 U. S. 320. Cf. *Parker v. New Orleans, etc. R. R. Co.*, 33 Fed. 693.

But see *Calhoun v. Memphis, etc. R. R. Co.*, 2 Flippin 442.

³ *Williamson v. New Jersey Southern R. R. Co.*, 26 N. J. Eq. 398.

⁴ *Mallory v. Maryland Glass Co.*, 131 Fed. 111.

⁵ *Smith v. McCullough*, 104 U. S. 25.

Cf. *Boston, etc. R. R. Co. v. Coffin*, 50 Conn. 150.

operation to property *ejusdem generis* as that more particularly described, — namely, to property in and about the telegraph offices, machine-shops, etc., — and did not cover real estate not within the more specific terms.¹

§ 1871. **Limits of Ejusdem Generis Rule for Construction of General Words accompanying Particulars.** — In most cases of corporation mortgages to secure an issue of bonds, the intention is to include within the charge, so far as practicable, all the property, present and future, of the company. In the present state of the American authorities, it is not thought safe to rely altogether upon such general language as “all the property now owned or hereafter to be acquired by the company”; and out of abundant caution some more particular description of certain kinds of the property is added, but with no intention of abandoning or restricting the more general words. In such cases, an application of the *ejusdem generis* rule should not be invoked to defeat the real intent. As Mr. Justice Samuel F. Miller said: “The more general words which include all that is intended to be conveyed are not to be frittered away by an attempt at a description of each particular thing, fairly included in the more general language.”² So, a charge of certain described property and all other property of the company has been held to cover its book accounts.³

§ 1872. **Property acquired by Company for experimental Purposes.** — Where a railway company charges all the “personal property belonging to said company, as the same now is in use by the said company, or as the same may be hereafter changed or renewed by said company,” the Vermont court held that the mortgage should be construed rather strictly so as not to embrace machinery for “burnetizing” ties and timber which was

¹ *Alabama v. Montague*, 117 U. v. *Chicago, etc. Co.*, 58 Miss. 896; S. 602; 6 Sup. Ct. 911. 38 Am. Rep. 348; *State v. Glenn*,

² *Alabama v. Montague*, 117 U. 18 Nevada 34, 47–48; 1 Pac. 186; S. 602, 610; 6 Sup. Ct. 911. Cf. *Brainerd v. Peck*, 34 Vt. 496; *Emerson v. European, etc. Ry. Co.*, 67 4 Biss. 35; *Raymond v. Clark*, 46 Me. 387; 24 Am. Rep. 39.

Conn. 129. ³ *Buvinger v. Evening Union*

But see *Mississippi Valley Co. Printing Co.* (N. J.), 65 Atl. 482.

not in existence at the time of the mortgage and which took the place of nothing that was then in existence but which was constructed by the railroad company as an experiment.¹

§ 1873. **The Company's Books.** — More general words in a mortgage, such as "other chattels," "other effects," and the like, will not, it seems, cover the company's books;² but the language used may be so broad and clear as to include the books.³

§ 1874. **Uncalled Capital — Unpaid Subscriptions.** — The English courts have been frequently called upon to decide whether general words in a charge or mortgage securing debentures cover capital which is still uncalled when the security comes to be enforced. This question has been but seldom raised in the United States, partly at least because the practice of carrying on business with a portion of the capital uncalled is not common in this country. Of course, no one has ever doubted that capital which was uncalled when the charge was created but which is subsequently called up and paid becomes property of the corporation and may be covered by the charge as after-acquired property;⁴ but the question is whether the holders of bonds or debentures can by way of enforcing their security require a call to be made for their benefit. Attention has already been directed to the fact that such a charge of uncalled capital is not necessarily *ultra vires* of the corporation;⁵ and the question now is whether, assuming it to be *intra vires*, it has in fact been created by the language used. The right to make calls upon unpaid or partly paid shares is not property, but a mere power. Hence, it is not covered by a charge upon the company's "property,"⁶ or "effects,"⁷ or "real and personal estate,"⁸ or "funds,"⁹ or

¹ *Brainerd v. Peck*, 34 Vt. 496.

⁵ *Supra*, § 72.

² *Clyde Tin Plate Co.*, 47 L. T. 439. As to book-debts, see *supra*, § 1869.

⁶ *Streatham & General Estates Co.* (1897), 1 Ch. 15; *Bank of South Australia v. Abrahams*, L. R. 6 P. C. 265; *Marine Mansions Co.*, 4 Eq. 601.

³ *Engel v. South Metropolitan Brewing Co.* (1892), 1 Ch. 442. Cf. *Lothrop Pub. Co. v. Williams*, 191 Mass. 361.

⁷ *Sankey Coal Co.* (No. 2), 10 Eq. 381.

⁴ Cf. *Sankey Coal Co.*, 9 Eq. 721; 10 Eq. 381; where it was held that a call made but still unpaid is "property" of the company.

⁸ *Ex parte Bradshaw*, 15 Ch. D. 465.

⁹ *Stanley's Case*, 33 L. J. Ch. 535.

But see *King v. Marshall*, 33 Beav. 565.

“undertaking,”¹ or “chartered rights, privileges, and franchises.”² On the other hand, uncalled capital has been held to be covered by a charge upon the company’s “assets.”³

The effect of such a charge in favor of debenture-holders is to give them a preference over the general creditors in respect to the proceeds of a call made by the liquidator in the winding-up proceedings;⁴ and indeed the liquidator may be compelled to make such calls as may be needed to pay off the debenture-holders, and must turn over the proceeds when collected to the debenture-holders.⁵ It does not, however, enable the mortgagee to levy calls without any action by the directors or by the receiver or liquidator.⁶

§ 1875. **Claims for Damages.** — A general charge upon all the company’s property has been held in England to be sufficient to cover moneys got in by the liquidator upon proceedings against the directors for mismanagement.⁷ On the other hand, it has been held by a federal court that an execution sale of the property franchises and rights of a corporation will not pass a claim for damages held by the company.⁸

§ 1876–§ 1879. *Revenues and Income.*

§ 1876. **Charge of Principal and Income distinguished from Charge of Income only.** — A charge upon a corporation’s revenues or income may be one of two kinds. In the first place, the charge may cover *only* the revenues and income, or it may include also the property from which, directly or indirectly, the revenues and income are derived. Any peculiarities of a charge of income

¹ *Russian Spratt’s Patent* (1898), 2 Ch. 149; *Marine Mansions Co.*, 4 Eq. 601.

² *Dean v. Biggs*, 25 Hun (N. Y.) 122. Cf. *Morris v. Cheney*, 51 Ill. 451; *Morgan County v. Thomas*, 76 Ill. 120; *Board of Comm’rs of Hamilton Co. v. State ex rel. Cottingham*, 115 Ind. 64; 4 N. E. 589; 17 N. E. 855.

³ *Page v. International, etc. Trust*, 62 L. J. Ch. 610.

⁴ *Pyle Works Co.*, 44 Ch. D. 534; *Anglo-Austrian Printing Union* (1895), 2 Ch. 891.

⁵ *Fowler v. Broad’s Patent Night Light Co.* (1893), 1 Ch. 724; *Harrison v. St. Etienne Brewery Co.* (1893), W. N. 108.

⁶ Cf. *Glenn v. Howard*, 65 Md. 40, 59; 3 Atl. 895 (as to the power of an assignee for the benefit of creditors).

⁷ *Anglo-Austrian Printing Union* (1895), 2 Ch. 891.

⁸ *International Coal Mining Co. v. Pennsylvania R. Co.*, 152 Fed. 551.

only, as distinguished from a charge of both income and principal, will be reserved for consideration in connection with the topic of income bonds.¹

§ 1877. **Of the Doctrine that Income earned before Mortgagee takes Possession is not covered by the Charge.** — Even where a mortgage or charge expressly covers income and revenues,² the mortgagee, if he have the right to take possession of the property from which the income is derived, cannot obtain a priority in respect to any income which was earned by the company before he either actually takes possession³ or makes a formal demand for payment of the revenues.⁴ Such earnings, not being covered by the lien of the bondholders, are subject to attachment at the suit of one of the general creditors,⁵ and so far as the mortgage bondholders are concerned, are chargeable with taxes and sim-

¹ See *infra*, § 2100-§ 2110.

² As to the power to mortgage future income, see *Georgia, etc. Ry. Co. v. Barton*, 28 S. E. 842; 101 Ga. 466 — a narrow decision which would hardly be followed in other states; for the power to mortgage property necessarily includes the power to mortgage income from that property. As to the law of Georgia, see further, *Lubroline Oil Co. v. Athens Sav. Bank*, 30 S. E. 409; 104 Ga. 376.

³ *Macalester v. Maryland*, 114 U. S. 598, 604-605; 5 Sup. Ct. 1065 (semble); *Am. Bridge Co. v. Heidelberg*, 94 U. S. 798; *Noyes v. Rich*, 52 Me. 115. Cf. *Milwaukee Ry. v. Brooks Locomotive Works*, 121 U. S. 430 (headnote inadequate); 7 Sup. Ct. 1094; *Roberts v. Denver, etc. R. R. Co.*, 8 Colo. App. 504; 46 Pac. 880; *McGraw v. Memphis, etc. R. R. Co.*, 5 Cold. (Tenn.) 434; *Parkhurst v. Northern Central R. R. Co.*, 19 Md. 472; 81 Am. Dec. 648; *Mississippi Valley, etc. Ry. Co. v. U. S. Express Co.*, 81 Ill. 534; *Platt v. New York, etc. Ry. Co.*, 63 N. Y. App. Div. 401; 71 N. Y. Supp. 913.

See also *Farmers' L. & T. Co. v. Cary*, 13 Wis. 110; *Alabama Nat. Bank v. Mary Lee, etc. Co.*, 108 Ala. 288; 19 So. 404; *Emerson v.*

European, etc. Ry. Co., 67 Me. 387; 24 Am. Rep. 39; *Rumsey v. People's Ry. Co.*, 91 Mo. App. 202; in which cases the charge did not expressly cover income.

But see *Ames v. Birkenhead Docks*, 20 Beav. 332; *Brady v. State*, 26 Md. 290, 309-311; *Linder v. Hartwell R. R. Co.*, 73 Fed. 320 (a case of fraudulent diversion of the income from the bondholders).

As to debts owing to the company at the time the trustees take possession, see *King v. Housatonic R. R. Co.*, 45 Conn. 226.

As to set-off of a debt of the company maturing after the trustees take possession, see *Murray v. Dayo*, 10 Hun (N. Y.) 3.

⁴ *Galveston R. R. Co. v. Cowdrey*, 11 Wall. 459, 482-483; *United States Trust Co. v. Wabash, etc. Ry. Co.*, 150 U. S. 287, 306-310; 14 Sup. Ct. 86.

⁵ *Smith v. Eastern R. R. Co.*, 124 Mass. 154; *Clay v. East Tenn., etc. R. R. Co.*, 6 Heisk. (Tenn.) 421; *Mississippi Valley, etc. Ry. Co. v. U. S. Express Co.*, 81 Ill. 534. See also cases cited in two last notes. Cf. *infra*, § 1924, § 1917.

But see *Galena, etc. R. R. Co. v. Menzies*, 26 Ill. 121; *Dunham v. Iselt*, 15 Iowa 284.

ilar expenses in proportion to the time during which they were earned.¹ It has been held that money representing income earned prior to a demand on behalf of the bondholders for possession of the property may in the discretion of a court of equity be applied exclusively to payment of unsecured claims;² but except in so far as this ruling may be supported under the doctrine of *Fosdick v. Schall*, it is believed to be contrary to principle, inasmuch as funds not covered by the mortgage should be distributed among all the creditors of the company *pari passu*, including the mortgage bondholders and the unsecured creditors.

§ 1878. **What amounts to a Taking of Possession by Bondholders within this Rule.**— If the trustee takes possession unjustifiably, subsequent earnings are not brought within the lien of the bondholders, but continue subject to attachment by general creditors.³ In the application of these principles it makes no difference that the bondholders may have filed a bill to subject to the payment of their claim profits earned prior to the filing of the bill and to a demand for possession;⁴ not being in law covered by the mortgage, they are not brought within its terms by an attempt of the bondholders to have them judicially declared to be so. The filing of a bill on behalf of the bondholders for foreclosure and sale, and even the passage thereon of a decree of sale, though without appointment of a receiver, will not be deemed so far equivalent to a taking of possession as to give the bondholders in respect to subsequent earnings from the mortgaged property a right in priority to the general creditors.⁵

On the other hand, the lien of the mortgage attaches to all income earned after the bondholders or their trustees have made a formal and regular demand for delivery of possession according to the terms of the mortgage; and the bringing of a suit for the purpose, not of foreclosure and sale, but of compelling the company to deliver possession of the mortgaged premises, constitutes such a demand.⁶ The appointment of a receiver for the

¹ *Atlantic Trust Co. v. Dana*, 128 Fed. 209, 230; 62 C. C. A. 657.

² *Farmers' L. & T. Co. v. American Waterworks Co.*, 107 Fed. 23.

³ *De Graff v. Thompson*, 24 Minn. 452.

⁴ *Am. Bridge Co. v. Heidelberg*, 94 U. S. 798.

⁵ *Gilman v. Illinois, etc. Tel. Co.*, 91 U. S. 603. Cf. *Fraser's Adm'r v. Richmond, etc. R. R. Co.*, 81 Va. 388.

But see *Farmers' L. & T. Co. v. Detroit, etc. R. R. Co.*, 71 Fed. 29, 37.

⁶ *Dow v. Memphis R. R. Co.*, 124 U. S. 652; 8 Sup. Ct. 673. Cf.

company at the suit of a judgment creditor or shareholder cannot be deemed an entry into possession by or on behalf of the bondholders so as to make their lien attach to subsequent earnings, even though the judgment creditor's bill stated that he sought relief subject to all the rights and equities of the bondholders;¹ and while an intervention in such a suit by the trustees of the bondholders asking possession of the property may be deemed a formal demand for possession so as to entitle them to the income thereafter accruing from the property,² yet intervention by certain of the bondholders who had recovered judgment against the company, individually and as judgment creditors rather than as holders of bonds, cannot have that effect.³ It would seem *a priori* that the appointment of a receiver in a suit on behalf of the bondholders for foreclosure and sale would cause the lien of the bondholders to attach to income earned during the receivership.⁴ The lien of the bondholders attaches to income earned by a receiver who was appointed at the instance of their trustee even though they opposed the passage of the order which

Farmers' L. & T. Co. v. Detroit, etc. R. R. Co., 71 Fed. 29.

But see *Georgetown Water Co. v. Fidelity Trust, etc. Co.*, 78 S. W. 113; 117 Ky. 325.

Moneys earned by the company before, but not collected until after, the filing of the bill and appointment of the receiver are not covered by the mortgage. *Hook v. Bosworth*, 64 Fed. 443; 12 C. C. A. 208.

¹ *Sage v. Memphis, etc. R. R. Co.*, 125 U. S. 361 (headnote inadequate); 8 Sup. Ct. 887; *Veatch v. American, etc. Trust Co.*, 79 Fed. 471; 25 C. C. A. 39; 84 Fed. 274; 28 C. C. A. 384; *Southern Ry. Co. v. Carnegie Steel Co.*, 76 Fed. 492, 498-499; 22 C. C. A. 289; *New England R. Co. v. Carnegie*, 75 Fed. 54; 21 C. C. A. 219.

As to the effect of bankruptcy of the corporation, see *Ellis v. Boston, etc. R. R. Co.*, 107 Mass. 1.

² *Atlantic Trust Co. v. Dana*, 128 Fed. 209; 62 C. C. A. 657. Cf. *Seibert v. Minneapolis, etc. Ry. Co.*, 52 Minn. 246; 53 N. W. 1151; *Giles v.*

Stanton, 86 Tex. 620; 26 S. W. 615.

³ *Sage v. Memphis, etc. R. R. Co.*, 125 U. S. 361; 8 Sup. Ct. 887. Cf. *United States Trust Co. v. Wabash, etc. Ry. Co.*, 150 U. S. 287; 14 Sup. Ct. 86.

⁴ *Central Trust Co. v. Chattanooga, etc. R. Co.*, 94 Fed. 275; 36 C. C. A. 241 (where the mortgage did not expressly cover income). Cf. *North Carolina R. R. Co. v. Drew*, 3 Woods 691, 712-713; *Downs v. Farmers' L. & T. Co.*, 79 Fed. 215; 24 C. C. A. 500; *State Trust Co. v. Kansas City, etc. R. Co.*, 120 Fed. 398, 405-406 (where the property had been sold under a foreclosure decree).

But see *Ellis v. Boston, etc. R. R. Co.*, 107 Mass. 1; *Douglass v. Cline*, 12 Bush. (Ky.) 608; *Frayser's Adm'r v. Richmond, etc. R. R. Co.*, 81 Va. 388. Cf. *Poland v. Lamoi-ville Valley R. R. Co.*, 52 Vt. 144, 174.

authorized the receiver to carry on the business and thus to earn the income.¹

§ 1879. **Whether Income earned while the Company is allowed to retain Possession can pass as After-acquired Property.** — The last two preceding sections deal with the rights of bondholders to the earnings and profits of the company under a charge on the revenues and income derived from certain property, such, for example, as a line of railway. It does not treat of the rights of bondholders to income and revenues by virtue of a charge of all the after-acquired property of the corporation. The so-called after-acquired property clause which is found in railway mortgages — and no doubt in many of those which were passed upon in the cases cited in the last paragraph — is often confined to such after-acquired property as is appurtenant to the railroad; and since money can hardly be deemed an appurtenance of the railway, the clause does not enlarge at all the rights of the bondholders with respect to the income and revenues. But where a general charge is made upon all present and in the future to be acquired property of a corporation, while the income from property of which the company is allowed to retain possession may not pass *qua* income, yet it is certainly after-acquired property and should pass as such. This result the English courts certainly would reach; and it is submitted that the American courts ought not to dissent.²

Of course, if a charge upon after-acquired property receives this broad construction, some power must be given to the company to deal with the property in the ordinary course of its business; and, if no such power is expressly reserved to the corporation, then the courts must read it into the deed of trust or mortgage; for otherwise the business of the company would be completely paralyzed. In other words, the mortgage must be construed as what the English call a “floating charge” — that is,

¹ *Boyce v. Continental Wire Co.*, 125 Fed. 740; 60 C. C. A. 508. receiver is subject to the lien of the bonds).

² See *Farmers' L. & T. Co. v. Detroit, etc. R. R. Co.*, 71 Fed. 29 (where it is held that income which was earned prior to the institution of a suit to enforce the security of mortgage bonds and which has come into the possession of the re- But cf. *Veatch v. American L. & Trust Co.*, 79 Fed. 471, 476-477; 25 C. C. A. 39; 84 Fed. 274; 28 C. C. A. 384; *New York Security, etc. Co. v. Saratoga Gas, etc. Co.*, 159 N. Y. 137; 45 L. R. A. 132; 53 N. E. 758.

a present charge subject to the power of the company while it remains a going concern to sell or dispose of its property in the ordinary course of business. To this conclusion, it is believed that the American courts in a case squarely presenting the point should and would come.¹

§ 1880. **The "Undertaking."** — In England, debentures are usually secured by a charge on the "undertaking." Now the undertaking of a corporation means its enterprise, its business. A charge upon the undertaking means, therefore, a charge upon everything that the company has or acquires, all its property and assets, present and future; but as the word necessarily implies that the company is to continue to prosecute its enterprise, although (to the extent of the charge) for the benefit of the debenture-holders, the charge is held to be subject to the power of the company to deal with its property in the ordinary course of business.² The mere use of this word, "undertaking," therefore, compendiously expresses the intent that, while the business of the company shall go on, the debenture-holders shall in case of a dissolution or insolvency of the corporation be entitled to a priority over other creditors in respect to any and all property which the company then owns; and hence one is not surprised to find that the draftsmen of English debentures and debenture deeds of trust usually make use of this succinct expression which has received lucid and authoritative interpretation by their courts.

§ 1881. **The "Plant."** — A mortgage of a manufacturing company's "plant" has been distinguished from the mortgage of the "undertaking," and held to cover only the "plant" as it existed

¹ Cf. *Clay v. East Tennessee, etc. R. R. Co.*, 6 Heisk. (Tenn.) 421; *New York Security, etc. Co. v. Saratoga Gas, etc. Co.*, 159 N. Y. 137; 45 L. R. A. 132; 53 N. E. 758.

But see *Emerson v. European, etc. Ry. Co.*, 67 Me. 387; 24 Am. Rep. 39.

² *Panama & Royal Mail Co.*, 5 Ch. 318; *Marshall v. Rogers, etc. Co.*, 14 Times L. R. 217.

But see *King v. Marshall*, 33

Beav. 565; *New Clydach Sheet & Bar Iron Co.*, 6 Eq. 514 (where Lord Romilly held, contrary to what would probably be decided to-day, that a mortgage of the undertaking did not cover after-acquired property).

A charge upon the "undertaking" does not cover uncalled capital. See *supra*, § 1874.

at the time of the mortgage, not covering after-acquired property.¹ The court said: "The two words" — that is, undertaking and plant — "are not equivalents and do not assimilate. One signifies a business or enterprise, and the other the fixtures and tools by which a business or enterprise is carried on."² At any rate, a mortgage of the "plant" of a beet sugar manufacturing company will not cover land subsequently acquired lying two hundred miles from the factory although intended for the purpose of raising beets in connection with the factory.³

§ 1882. **Goodwill.** — The company's goodwill is an important element in its undertaking, and may indeed be deemed the most essential feature of a charge upon the business. A mortgage or charge upon all the "property . . . and effects, whatsoever, both present and future" has been held to be a charge upon the company's goodwill or business.⁴

§ 1883-§ 1884. *The "Franchise" or "Franchises."*

§ 1883. **In general.** — In the United States one often finds a so-called mortgage or charge upon the franchise or franchises of the corporation. The precise meaning of the word franchise in this connection is not entirely clear. A vague idea is sometimes discoverable in the judicial mind that the term is almost synonymous with the English "undertaking" — that is, the company's entire enterprise or business.⁵ For instance, a mortgage by a water-works company of its "franchise" covers its

¹ *Maxwell v. Wilmington Dental Mfg. Co.*, 77 Fed. 938. Cf. *Adamant Plaster Co.*, 137 Fed. 251.

² *Maxwell v. Wilmington Dental Mfg. Co.*, 77 Fed. 938, 941.

³ *Old Colony Trust Co. v. Standard Beet Sugar Co.*, 150 Fed. 677. As to a mortgage of the "machinery" of a manufacturing company, see *Doty v. Oriental Print Works Co.* (R. I.), 67 Atl. 586.

⁴ *Leas Hotel Co.* (1902), 1 Ch. 332.

⁵ *Parker v. New Orleans, etc. R. R. Co.*, 33 Fed. 693; *Phillips v. Winslow*, 18 B. Monr. (Ky.) 431; 68 Am. Dec. 729; *Seymour v. Canadaigua, etc. R. R. Co.*, 25 Barb. (N. Y.) 308; *Stevens v. Watson*, 4 Abb. Ct. App.

Dec. (N. Y.) 302, 304; *Andrews v. Nat. Foundry, etc. Works*, 76 Fed. 166; 22 C. C. A. 110; 77 Fed. 774; 23 C. C. A. 454; 36 L. R. A. 139.

Cf. *Eldridge v. Smith*, 34 Vt. 484; *Pierce v. Emery*, 32 N. H. 484; *Dunham v. Earl*, 8 Fed. Cas. 41, No. 4, 149.

But see *Shamokin Valley R. R. Co. v. Livermore*, 47 Pa. St. 465; 86 Am. Dec. 552; *Dinsmore v. Racine, etc. R. R. Co.*, 12 Wisc. 649; *Louisville Trust Co. v. Cincinnati Inclined-Plane Ry. Co.*, 91 Fed. 699 (where it was held that a mortgage of the company's franchise does not carry after-acquired property).

plant.¹ Of course, the company may possess true franchises, such as a franchise to exact tolls from users of a public highway, a franchise to do what would otherwise amount to a public nuisance, etc. Such special privileges are ordinarily inalienable;² but sometimes special legislative permission enables them to be assigned or pledged.³ What is meant by a mortgage of such franchises is, therefore, clear enough. The mortgagee acquires the right to enjoy the franchises himself or have them sold for his benefit, just like a parcel of mortgaged land.⁴ A distinction should be noted between franchises granted by the state, which cannot be assigned or mortgaged without special authority, and contracts with a mere municipal corporation, which may ordinarily be assigned and mortgaged to the same extent as contracts with private persons.⁵

§ 1884. **The "Franchise" to be a Corporation.** — The right or so-called franchise to be a corporation is very different in nature. Very clearly it cannot be assigned or mortgaged without express legislative authority. It will not pass by a mortgage, under legislative sanction, of the company's "charter and

¹ *Andrews v. National Foundry, etc. Works*, 76 Fed. 166, 176; 22 C. C. A. 110; 77 Fed. 774; 23 C. C. A. 454; 36 L. R. A. 139.

² See Short's Law of Railway Bonds and Mortgages, § 149.

But see *Bardstown, etc. R. R. Co. v. Metcalfe*, 4 Metc. (Ky.) 199; 81 Am. Dec. 541.

³ Cf. *Joy v. Jackson, etc. Plank Road Co.*, 11 Mich. 155; *City of Quincy v. Burlington, etc. R. R. Co.*, 94 Ill. 537; *Chadwick v. Old Colony R. R. Co.*, 50 N. E. 629; 171 Mass. 239 (permission to mortgage franchise held to be granted without express words). A mortgage of such franchises though made without authority may be ratified by subsequent legislative recognition of its validity. *Hall v. Sullivan R. R. Co.*, 1 Brunner Coll. Cas. 613. Permission to sell a franchise confers power to mortgage it. *Willamette Mfg. Co. v. Bank of British Columbia*, 119 U. S. 191; 7 Sup. Ct. 187.

As to whether an exemption from

taxation can be assigned or mortgaged, see *Memphis, etc. R. R. Co. v. Railroad Comm'rs*, 112 U. S. 609; *Picard v. East Tennessee, etc. R. R. Co.*, 130 U. S. 637; *Chesapeake & Ohio Ry. Co. v. Miller*, 114 U. S. 176; *Morgan v. Louisiana*, 93 U. S. 217; *First Division of St. Paul, etc. R. R. Co. v. Parcher*, 14 Minn. 297; Jones on Corporate Bonds and Mortgages, 3d ed., § 693. The franchises of a railway company may pass under a mortgage of its "property, etc."; *Bardstown, etc. R. R. Co. v. Metcalfe*, 4 Metc. (Ky.) 199; 81 Am. Dec. 541.

⁴ *Willamette Mfg. Co. v. Bank of British Columbia*, 119 U. S. 191; 7 Sup. Ct. 187.

Cf. *Farmers' L. & T. Co. v. Meridian Waterworks Co.*, 139 Fed. 661.

⁵ *Omaha Water Co. v. City of Omaha*, 147 Fed. 1, 14-15; 77 C. C. A. 267. Cf. *State v. Topeka Water Co.*, 61 Kans. 547; 60 Pac. 337.

works,"¹ or "franchises."² Hence, a corporation whose franchises have been sold under a judicial decree may nevertheless prosecute an appeal from a subsequent decree distributing the proceeds of sale.³ Indeed, the right or privilege to be a corporation, even if it be in a true sense a franchise, is the franchise not of the company but of the several members.⁴ It is hard to see how even the "omnipotence" of Parliament can confer upon either a natural or artificial person the power to mortgage his or its own personality. To be sure, statutes may and sometimes do provide that the purchasers of all the property of a corporation at a foreclosure sale shall have the right to organize a corporation, or even that they shall *ipso facto* by virtue of their purchase become incorporated.⁵ In one sense, by the aid of such statutes, the mortgage conveys the right to be a corporation. Yet, even in those cases, the purchasers while they become a corporation do not become the same corporation as the mortgagor.⁶ The new company derives its corporate existence

¹ *Memphis, etc. R. R. Co. v. Railroad Commissioners*, 112 U. S. 609; 5 Sup. Ct. 299.

² Cf. *Eldridge v. Smith*, 34 Vt. 484; *Meyer v. Johnston*, 53 Ala. 237, 325-327.

But see *First Division of St. Paul, etc. R. R. Co. v. Parcher*, 14 Minn. 297.

³ *Ohio Central R. R. Co. v. Central Trust Co.*, 133 U. S. 83; 10 Sup. Ct. 235. Cf. *Rogersville, etc. R. R. Co. v. Kyle*, 9 Lea (Tenn.) 691.

⁴ *Memphis, etc. R. R. Co. v. Railroad Commissioners*, 112 U. S. 609, 619; 5 Sup. Ct. 299; *Meyer v. Johnston*, 53 Ala. 237, 325-326.

⁵ *Chesapeake, etc. Ry. Co. v. Miller*, 114 U. S. 176; 5 Sup. Ct. 813; *Holland v. Lee*, 71 Md. 338; 18 Atl. 661.

Cf. *Rogers v. Nashville, etc. Ry. Co.*, 91 Fed. 299, 319-321; 33 C. C. A. 517 (where the purchaser, who was a natural person, sold the purchased property, consisting of a line of railway, to an existing corporation); *French v. Jones*, 191 Mass. 522; 78 N. E. 118; 7 L. R. A., n. s., 525 (holding that purchaser is under

no obligation to organize a corporation); *Carolina Coal, etc. Co. v. Southern Ry. Co.* (N. Car.), 57 S. E. 444 (holding that a foreign corporation on purchasing the property and franchises of a domestic corporation at a foreclosure sale, became *ipso facto*, by virtue of the statute, a domestic corporation); *Texas Southern Ry. Co. v. Harle* (Tex.), 105 S. W. 1107 (holding that upon organization of a new corporation in pursuance of the statute, title to the mortgaged property and franchises vests in that company without any deed from the purchasers notwithstanding the fact that one of the latter was a married woman).

⁶ *Chesapeake, etc. Ry. Co. v. Miller*, 114 U. S. 176; 5 Sup. Ct. 813; *Morgan County v. Thomas*, 76 Ill. 120; *Metz v. Buffalo, etc.*, 58 N. Y. 61, 65-66; 17 Am. Rep. 201.

Cf. *Memphis, etc. R. R. Co. v. Railroad Commissioners*, 112 U. S. 609; 5 Sup. Ct. 299; *First Division of St. Paul, etc. R. R. Co. v. Parcher*, 14 Minn. 297; *Hatcher v. Toledo, etc. R. R. Co.*, 62 Ill. 477; *Commonwealth v. Central Pass. Ry. Co.*, 52

from the statute, and not by assignment from the old corporation. Hence, the new company is liable to any organization or incorporation tax or fee imposed by law on new corporations.¹ In these days of general incorporation laws of very great liberality, any special right of purchasers at a foreclosure sale to be or to form a corporation is of much less value than formerly.

§ 1885. **Effect of Attempt to mortgage inalienable Rights.** — The fact that a mortgage may purport to cover property or rights which the company is without power to alien or charge does not invalidate the security *in toto*. At most, it is void as to such property or rights only.²

§ 1886-§ 1902. *RIGHTS OF BONDHOLDERS INTER SESE.*

§ 1886-§ 1894. *RIGHTS INTER SESE OF HOLDERS OF BONDS ALL OF WHICH ARE OF THE SAME SERIES.*

§ 1886-§ 1893. *Effect of a Provision that all the Bonds of the Series shall rank Pari Passu.*

§ 1886. **In general — Who may claim the Benefit of Pari Passu Clause.** — Ordinarily the intention is that all bonds or debentures of the same series shall rank *pari passu* without priority by reason of date, number, or otherwise; and usually this intent is evinced by an express declaration to that effect in the instruments themselves and in the deed of trust by which they are secured.³ Under such a clause debentures which are issued

Pa. St. 506; *Wellsborough, etc. Co.*, 4 Biss. 35; *Carpenter v. Black Plank-Road Co. v. Griffin*, 57 Pa. St. 417; *Pittsburgh, etc. Ry. Co. v. Fierst*, 96 Pa. St. 144; *Mobile, etc. Ry. Co. v. Steiner*, 61 Ala. 559; *Vilas v. Milwaukee, etc. Ry. Co.*, 17 Wisc. 497; *Morgan County v. Thomas*, 76 Ill. 121.

¹ *People ex rel. Schurtz v. Cook*, 110 N. Y. 443; 18 N. E. 113.

² *Buller v. Rahm*, 46 Md. 541, 547; *Pullan v. Cincinnati, etc. R. R.*

Co., 4 Biss. 35; *Carpenter v. Black Hawk Gold Mining Co.*, 65 N. Y. 43.

³ Bonds issued in payment for after-acquired property have no priority with respect to that property over other bonds of the same series. *Murray v. Farmville, etc. R. R. Co.*, 43 S. E. 553; 101 Va. 262.

As to the effect of a lien attaching to the mortgaged property after the execution of the mortgage and before the issue of all the bonds se-

by the company after the institution of a suit against it by debenture-holders to enforce their security, but before the appointment of a receiver, stand on an equality with the holders of the debentures of the same series previously issued.¹

Moreover, a *pari passu* clause of this sort may be availed of by any one who as against the company is entitled to rank as a holder of bonds or debentures of the series, provided any instruments of that series remain unissued. Thus, a person who by reason of contract with the company is entitled to have bonds or debentures of a certain series issued to him, although they have not been actually issued, stands in equity upon an equality with holders of bonds of that series although thereby the security of the latter is diminished.² Thus, upon principle, it would seem that a person whose ownership of bonds or debentures of a certain series the company is estopped to deny might claim the right of equality with actual holders of instruments of that series.³ If, however, all bonds of that series have been issued, a mere contract, estoppel, or other equity entitling a person as against the company to rank as if bonds had been issued to him cannot well be availed of against the bondholders themselves.⁴ The same principles apply to the amount of proof in bankruptcy or liquidation proceedings: if a holder is, as against the corporation, entitled to prove for the full nominal amount of his bonds, he is likewise entitled to do so in competition with other bondholders.⁵ For instance, if bonds are issued by a corporation as collateral security for an indebtedness less than their nominal amount, the creditor to whom they were issued may in competition with the other bondholders prove against the security for the par value of the bonds, receiving dividends, of course, only to the amount of his debt.⁶

cured thereby, in making a distinction between bonds previously and subsequently issued, see *supra*, § 1848.

As to the effect of registering a series of debentures, under the British Companies Act of 1900, as ranking *pari passu*, see *Leicester v. Yolland, Husson & Birkett* (1908), 1 Ch. 152.

¹ *Hubbard & Co.*, 68 L. J. Ch. 54.

² *Supra*, § 1722.

³ But see *Mowatt v. Castle Steel*,

etc. Co., 34 Ch. D. 58 (attempted to be distinguished in *Robinson v. Montgomeryshire Brewery Co.* (1896), 2 Ch. 841, 849-850); *W. Tasker & Sons* (1905), 2 Ch. 587.

⁴ See *supra*, § 1723, and *infra*, § 1888.

⁵ Cf. *Booker v. Crocker*, 132 Fed. 7; 65 C. C. A. 627.

⁶ *Regent's Canal Ironworks Co.*, 3 Ch. D. 43.

Cf. *Robinson v. Montgomeryshire*

It would seem clear that bonds which lie dormant and unissued are not within a *pari passu* clause and that the holders of the bonds which are issued are entitled to exhaust the entire security, and not merely to receive that portion thereof which they would have been entitled to if the unissued bonds had been issued.¹

§ 1887. **As affected by Orders of Court.** — The courts will take care that no order passed *alio intuitu* should have the incidental effect of destroying the equality sought to be secured by a *pari passu* clause. For example, where some of the bonds or debentures are not issued until after the passage of an act requiring them to be registered, an order of court directing them to be registered without prejudice to the rights of parties acquired prior to the time of actual registration should be qualified so as clearly to provide that the bonds or debentures issued prior to the passage of the act should not be taken by virtue of this "without prejudice" clause to have any priority over the bonds or debentures of the same series subsequently issued and directed to be registered.²

§ 1888. **Overissued Bonds.** — Cases of an overissue of bonds — that is to say, bonds issued in excess of the authorized number of the series — present many legal difficulties. We have seen that a mere contract by the company to issue bonds to a certain person does not entitle him, however innocently he may have acted, to rank as a bondholder, if the entire issue has already been taken up by other persons.³ But in a case of actual overissue, where the overissued bonds have reached the hands of *bona fide* purchasers, it has been held that all the bonds are entitled to share in the proceeds of the security.⁴

§ 1889. **Contracts by the Company not to issue more than a certain number of Bonds of a certain Series.** — As the interest of every bondholder is to reduce to a minimum those who may participate

Brewery Co. (1896), 2 Ch. 841. See also *supra*, § 1699.

¹ *Coal Co. v. Land Co.*, 106 Tenn. 41; 60 S. W. 502; *Merchants' Nat. Bank v. Goddin*, 76 Va. 503. See also *supra*, § 1848.

² *I. C. Johnson & Co.* (1902), 2 Ch. 101.

³ *Supra*, § 1723.

⁴ *Stanton v. Alabama, etc. R. R. Co.*, 2 Woods 523.

As to whether the overissued bonds would be entitled to the lien of the mortgage as against the company, subsequent encumbrancers and general creditors, see *Farmers' L. & T. Co. v. Toledo, etc. Ry. Co.*, 67 Fed. 49, 59-60 (stated *infra*, § 1889).

in his security *pari passu* with himself, a contract by the company with a bondholder not to issue more than a certain number of bonds of his series is very advantageous for him. Such a contract will be enforced by the courts in the only adequate and effective manner; that is to say, bonds issued in violation of such an agreement, unless they have come to the hands of a holder for value without notice, will not be allowed to rank equally with the bonds of the other party to the broken contract.¹ The recording of such a contract will not, however, operate as constructive notice thereof.² Where a railway mortgage stipulates that bonds shall not be issued thereunder to a greater amount than a certain number for each mile of road constructed, bonds issued in violation of this provision may be invalid as regards other bondholders but they are good as against the corporation and unsecured creditors, and are therefore properly treated as outstanding for purposes of a foreclosure decree.³

· § 1890. **Contracts by the Company fixing a minimum Price at which Bonds may be issued.**— Because of the interest which a bondholder has in the success of the corporation, a contract between him and the company that bonds shall not be issued at less than a certain rate would be reasonable enough. If such a contract were proved, a holder of bonds issued at a less rate in violation thereof, unless he or some prior holder took without notice of the agreement, would probably be debarred from proving for the full nominal value of the bonds in competition with the person with whom the company in issuing the bonds had broken faith. A contract of that sort cannot be implied, however, because at the time the first of the bonds were issued the company had resolved to issue no bonds at less than a certain percentage of the face value.⁴

§ 1891. **Bonds issued without Payment of Value.**— Even without any such contract, it has been thought that “every bondholder has the right to insist that every other bond shall represent

¹ *McMurray v. Moran*, 134 U. S. 150, 158 (headnote inadequate); 150; 10 Sup. Ct. 427; *Union Trust Co. v. Nevada, etc. R. R. Co.*, 10 Sup. Ct. 427.

² *Farmers' L. & T. Co. v. Toledo, etc. Ry. Co.*, 67 Fed. 49, 59–60.

³ *Regent's Canal Ironworks Company*, 3 Ch. D. 43. Cf. *Dalrymple v. Lauman*, 23 Md. 376 (stated *supra*,

⁴ *McMurray v. Moran*, 134 U. S. § 172S).

value and certainly that it shall be lawfully and honestly issued," so that the common security be not burdened by bondholders whose claims are based on scant equities. How far this apparently just doctrine would be recognized, the existing authorities do not enable us to say. As stated above, there is no rule of common law prohibiting the issue of bonds for less than their par value.² On the other hand, statutes sometimes provide that bonds shall not be issued except for money, labor, or property actually received and that all "fictitious" indebtedness shall be void.³

§ 1892. **Right of Bondholder to bring Suit on his Bonds for his individual Benefit.** — The provision that all bonds or debentures of a series shall rank equally places an obstacle in the way of an action at law by any bondholder upon his own bonds. For, if any bondholder could obtain a judgment against the corporation, he might by superior diligence in instituting or prosecuting an action secure an advantage over his fellow-bondholders, and thus defeat the intended equality. This argument is particularly strong where as in England all the property of the company is embraced within the debenture-holders' charge; for if an individual debenture-holder could obtain a judgment and seize the company's chattels on execution, he would thus appropriate exclusively to his own claim property that by the clear terms of the charge was intended for the equal benefit of all. Accordingly, it is generally agreed that a holder of bonds or debentures will not be permitted to seize on execution for his individual benefit any property that is covered by the common charge in favor of himself and his fellows.⁴ The result is that if the charge covers

¹ *Currier v. N. Y., etc. R. R. Co.*, Fed. 137; 61 C. C. A. 203; *Martin 35 Hun (N. Y.)*, 335, 360 (headnote inadequate).

But see *Bibb v. Montgomery Iron Works*, 101 Ala. 301; 13 So. 224 (stated supra, § 1693).

² Supra, § 1693 et seq.

³ Supra, § 1695.

⁴ *Bowen v. Brecon Ry. Co.*, 3 Eq. 541; *Uruguay Central, etc. Ry. Co.*, 11 Ch. D. 372, 381; *Pennock v. Coe*, 23 How. 117, 131; *Hackettstown Nat. Bank v. Yuengling Brewing Co.*, 74 Fed. 110; 20 C. C. A. 327; *Kimber v. Gunnell Gold, etc. Co.*, 126 Pa. 366 (headnote inadequate); *Fed. 137*; 61 C. C. A. 203; *Martin & Merriwether v. Mobile & Ohio R. R. Co.*, 7 Bush (Ky.) 116, 124; *Du Pont v. Bushong* (U. S. Circ. Ct.), 1 Wkly. Notes Cas. (Pa.) 378 (semble); *Commonwealth v. Susquehanna, etc. R. R. Co.*, 122 Pa. St. 306; 15 Atl. 448; 1 L. R. A. 225 (holding that a purchaser at the execution sale does not get a good title); *Western Pennsylvania Hospital v. Mercantile Library Hall Co.*, 189 Pa. St. 269; 42 Atl. 183; *Philadelphia, etc. R. R. Co. v. Woelper*, 64

all the company's property, the recovery of a judgment by the bondholder is futile, inasmuch as any execution thereon will be restrained. Moreover, a bondholder will not be allowed by taking out execution upon a judgment in his favor to seize income of the company which although covered by the mortgage is, on principles elsewhere stated,¹ subject to attachment at the instance of judgment creditors in general.² Ordinarily, the *pari passu* clause is not pleadable in bar of an action at law by an individual bondholder,³ but only operates as a restraint on execution. In some cases, however, the action will not be allowed to be prosecuted to judgment.⁴ For example, where an act of Parliament authorized a canal company to borrow money on the security of its canal, and provided that the creditors should have no priority over each other, it was held that an individual bondholder could not maintain an action at law against the company upon the covenant contained in his bonds.⁵ For similar reasons, a bill in equity cannot be maintained by an individual bondholder to enforce the security unless he sue on behalf of

Railways Company General v. Newtown Electric Street Ry., 32 Pa. Co. Ct. Rep. 38 (semble); *Guaranty Trust Co. v. Troy Steel Co.*, 33 N. Y. Misc. 484; 68 N. Y. Supp. 915.

Cf. *Bolckow v. Herne Bay Pier Co.*, 1 E. & B. 74; *Fountaine v. Carmathen Ry. Co.*, 5 Eq. 316, 324-325 (holding that where the debenture-holder has actually collected the amount of his judgment, the court will not cancel the transaction but will regard his debentures as paid off); *West Branch Bank v. Chester*, 11 Pa. St. 282; 51 Am. Dec. 547.

¹ *Supra*, § 1877, § 1879.

² *Roberts v. Denver, etc. Ry. Co.*, 8 Colo. App. 504; 46 Pac. 880.

³ *Bolckow v. Herne Bay Pier Co.*, 1 E. & B. 74; *Manning v. Norfolk Southern R. Co.*, 29 Fed. 838; *Roberts v. Denver, etc. Ry. Co.*, 8 Colo. App. 504; 46 Pac. 880 (semble); *Philadelphia, etc. R. R. Co. v. Johnson*, 54 Pa. St. 127; *Wjdener v. Railroad Co.*, 1 Wkly. Notes Cas. (Pa.) 472; *Western Pennsylvania Hospital v. Mercantile Li-*

brary Hall Co., 189 Pa. St. 269; 42 Atl. 183; *Railways Company General v. Newtown Electric Street Ry.*, 32 Pa. Co. Ct. Rep. 38.

Cf. *Texas, etc. Ry. Co. v. Marlbor*, 123 U. S. 687; 8 Sup. Ct. 311 (affirming 19 Fed. 867); *Sage v. Memphis, etc. R. R. Co.*, 125 U. S. 361; 8 Sup. Ct. 887; *Welsh v. First Division St. Paul, etc. R. R. Co.*, 25 Minn. 314 (action maintainable notwithstanding pendency of foreclosure suit); *Coleman v. Llanelly Ry., etc. Co.*, 17 L. T. 86.

⁴ Cf. *Guilford v. Minneapolis, etc. Ry. Co.*, 48 Minn. 560; 51 N. W. 658; 31 Am. St. Rep. 694 (enforcing an express provision that no bondholder should sue at law or in equity except upon certain conditions); *Holmes v. Seashore Electric Ry. Co.*, 57 N. J. Law 16 (applying a statute prohibiting actions on the bonds until after foreclosure of the mortgage).

⁵ *Pontet v. Basingstoke Canal Co.*, 3 Bing., N. c., 433.

all.¹ Moreover, a clause restraining debenture-holders from suing to enforce the security, until the trustees of the covering deed should have refused to do so after written request, has been held to prevent an action at law by a debenture-holder upon the covenant contained in his debenture until a refusal by the trustees;² but in this case the security extended to all the property of the company, so that the debenture-holder might have experienced difficulty in obtaining satisfaction by action at law even if the clause in question had had no application to such a proceeding.

In any case, in the absence of an express prohibitory provision, individual bondholders would be at liberty to proceed against a guarantor or against a person who contracted with the obligor company to pay the bonds or maturing coupons.³

§ 1893. **Whether one Bondholder on paying off or buying a prior Encumbrance can be subrogated to its Priority over his fellow Bondholders.** — Where a bondholder, for the purpose of saving the common security, pays off a prior lien thereon, such as a lien for overdue taxes, it has been held that he is entitled to be subrogated to the priority over the other bondholders of the claim so discharged,⁴ no *pari passu* clause being construed to interfere with any such right of subrogation; but on the other hand, a federal circuit court of appeals has held that in such a case, the bondholder buying in the prior encumbrance holds the same in trust for his fellow-bondholders, subject of course to a right of indemnification for the amount actually expended by him.⁵ The principle of this latter decision, if sound, would seem to be very far-reaching. For example, it would preclude a holder of second-mortgage bonds from buying and holding for his own benefit

¹ *New Orleans Ry. Co. v. Parker*, 143 U. S. 42; 12 Sup. Ct. 364.

But see *Spies v. Chicago, etc. R. Co.*, 30 Fed. 397.

See also *infra*, § 1972.

As to the right of an individual bondholder as a creditor to maintain a statutory proceeding in equity for winding-up and dissolution of the corporation, see *Olathe Silver Mining Co.*, 27 Ch. D. 278 (distinguishing *Uruguay Central, etc. Ry. Co.*, 11 Ch. D. 372); *Borough of Portsmouth, etc. Tramways Co.* (1892), 2

Ch. 362; *Reinhardt v. Interstate Tel. Co.* (N. J. Ch.), 63 Atl. 1097, 1098-1099.

² *Rogers & Co. v. British & Colonial Ass'n*, 68 L. J. Q. B. 14.

³ *Mercantile Trust Co. v. Baltimore, etc. R. R. Co.*, 94 Fed. 722. Cf. *supra*, § 1863.

⁴ *Humphreys v. Allen*, 100 Ill. 511. Cf. *Moore v. Peruvian Corp.* (1908), 1 Ch. 604, 614.

⁵ *Booker v. Crocker*, 132 Fed. 7; 65 C. C. A. 627.

first-mortgage bonds — an application of the principle which no court would be willing to accept.

§ 1894. **Rights of Bondholders Inter Sese in the Absence of an express Pari Passu Clause.** — Where, as in America, the mortgage or charge securing a whole series of bonds or debentures is created by a single instrument or deed of trust an express provision that all the instruments secured thereby shall rank *pari passu* without priority of one over another by reason of date, number, or otherwise, although usual and expedient, is perhaps not indispensably necessary. Possibly, the same result might be reached by inference from the execution of one covering deed and from well-nigh universal mercantile custom.¹ Where, however, as is frequently done in England, each debenture itself creates the charge by which it is secured, a declaration that all shall rank equally is indispensable; for without it the debentures, even those which form one series, take priority, one over another, either according to their numbers or according to their dates of issue.²

§ 1895–§ 1902. *Relative Rights of Holders of Bonds of different Series.*

§ 1895. **In general.** — As between bonds or debentures of different series, there can usually be no question as to which is entitled to priority or whether both are to rank *pari passu*. So important a question is rarely left to inference. Moreover, if the whole of one series is regularly issued, and secured by a first mortgage, any series subsequently issued must necessarily rank in subordination to the former, whether or not any direct provision is made to that effect, or indeed even in spite of a provision

¹ Cf. *Pittsburgh, etc. Ry. Co. v. Cobb*, 64 Ala. 127, 157–158; *Stanton v. Alabama, etc. R. R. Co.*, 2 Woods 523; *Birdsall v. Russell*, 29

² *James v. Boythorpe Colliery Co.*, 2 Megone 55; *Gartside v. Silkstone, etc. Co.*, 21 Ch. D. 762, 766.

As to the numbering of bonds, see further *State ex rel. Plock & Co.* 114.

to the contrary. Upon the same principle, a statutory provision that "the holders of debenture stock shall not as among themselves be entitled to any preference or priority" does not apply as between the holders of distinct issues of debenture stock respectively created under special acts of Parliament, but such issues take priority according to date.¹

§ 1896. **Bonds of first-mortgage Series issued after Execution of second Mortgage and Issue of Bonds secured thereby.** — Where a second series of debentures is issued expressly subject to debentures of a prior series, both sets of debentures containing a clause that all of the same series shall rank "ratably and equally *inter se* without any preference or priority one over another," all the debentures of the first series have a priority over all of the second series, even though some of the first series were issued after some of the second.² Indeed, it is not uncommon to issue simultaneously two sets of bonds, one secured by a first mortgage and one by a second mortgage, and no one has ever questioned that a first-mortgage bond has a priority over even those second-mortgage bonds which happened to have been issued before it was issued. If, however, any bonds or debentures of the first series are paid off, instruments issued in their place will probably not be entitled to priority over bonds or debentures of the second series.³ But if engraved bonds are exchanged for lithographed bonds of the same tenor and numbers, the latter will be deemed mere duplicates of the former, and the rights of the holders will not be affected by the transaction.⁴

§ 1897. **Priorities where there is no covering Deed of Trust or Mortgage.** — Where two sets of debentures were issued on the same day, numbered respectively from 501 to 600 and from 601 to 650, each debenture of the former set containing a statement that it was one of a series of 100 all of which should rank *pari passu* without priority by reason of date or otherwise, and the

¹ *Mersey Ry. Co.* (1895), 2 Ch. 287. *R. R. Co.*, 8 Fed. 118, 124; *Re Fifty-four First-Mortgage Bonds*, 15 S. Car. 304.

² *Lister v. Henry Lister & Sons*, 62 L. J. Ch. 568; *Claflin v. South Carolina K. R. Co.*, 8 Fed. 118. Cf. *supra*, § 1848. See *supra*, § 1718 and § 1820. ⁴ *Illinois, etc. Bank v. Pacific Ry. Co.*, 117 Cal. 332; 49 Pac. 197.

³ *Lister v. Henry Lister & Sons*, 62 L. J. Ch. 568.

But see *Claflin v. South Carolina*

debentures of the other set being precisely similar except that the number of debentures in the series to which they belonged was stated to be fifty instead of a hundred, the court held that an intent for one series to rank in preference to the others was apparent, and that in the absence of any clear provision as to which series should have the priority, the debentures of the first set, which bore the lower numbers and which had been sealed before the others, should have the preference.¹

§ 1898. **Right of second-mortgage Bondholders to attack Validity of prior Mortgage.** — The holders of bonds secured by a mortgage which is not made expressly subject to a prior mortgage have the same right as the corporation to dispute the legality or validity of the earlier mortgage.²

§ 1899. *As to Property which was not included in the prior Mortgage.* — Where the language of a second mortgage is broad enough to cover certain property that was not included in the prior mortgage the bondholders or their trustees are not estopped from denying that this property was included in the first mortgage by the fact that their mortgage is expressed to be subject to the lien of the earlier charge which should be "in all respects a prior, superior and senior lien upon the property and premises described therein, acquired and to be acquired."³

§ 1900. *As to Property from which the Company covenanted to set apart a Portion as subject to the prior Mortgage.* — Where a railway company executes a mortgage upon a certain division of its line, and covenants to set apart and designate as appurtenant to that portion of its line and as therefore subject to the mortgage such proportion of its rolling stock as the division bears to the entire line of railway, a subsequent mortgage to secure another issue of bonds, covering all the company's railroad and rolling stock, will have priority over the former mortgage in respect to the rolling stock which the company by its covenant ought to have designated as subject to the earlier mortgage, but which it neglected so to designate and set apart.⁴

¹ *Gartside v. Silkstone, etc. Co.*, 21 Ch. D. 762.

³ *Farmers' L. & T. Co. v. Commercial Bank*, 15 Wisc. 424; 82

² *Commonwealth v. Smith*, 10 Allen (Mass.), 448; 87 Am. Dec. 672.

Am. Dec. 689. ⁴ *United States Trust Company v. Wabash, etc. Ry. Co.*, 38 Fed. 891.

§ 1901. **Res Judicata as to relative Priorities of two Series of Bonds.** — The relative priorities of two sets of mortgage bonds may of course be *res judicata*. And a suit to foreclose or enforce the security of one of the mortgages is, if the trustees of both mortgages are parties, a proper place for the final determination of the question of relative priority.¹

§ 1902. **Estoppel of first-mortgage Bondholders to claim their Priority.** — Peculiar circumstances, such as fraud and misrepresentation, may give rise to an estoppel by which holders of the first mortgage bonds shall be postponed to holders of bonds secured by a nominally second mortgage,² or even to unsecured creditors.³

§ 1903-§ 1958. RELATIVE PRIORITIES OF BOND-HOLDERS AND OTHER PERSONS WHOSE CLAIMS ARISE WHILE THE COMPANY IS A GOING CONCERN.

§ 1903. **In general — Scheme of Treatment.** — In order to determine the relative priorities between bonds or debentures, or the mortgage or charge by which they are secured, and other liens, rights, or equities created by the company while it is a going concern, reference must be had to general principles of the law of mortgages and charges.⁴ Almost the only peculiar questions arise (1) with respect to the effect of a charge on after-acquired property, (2) with respect to claims which are placed by statute on a preferential footing, and (3) with respect to the power of the company to deal with its property in the ordinary course of business as if the lien of the bonds or debentures did not exist.

¹ *Board of Supervisors v. Mineral Coal Co.*, 16 Wash. 499; 48 Pac. Point R. R. Co., 24 Wisc. 93. Cf. 333, 737.

Woods v. Pittsburgh, etc. Ry. Co., 99 Pa. St. 101. ⁴ Cf. *Louisville, etc. R. R. Co. v. Schmidt*, 52 S. W. 835; 21 Ky. Law

² *Hooper v. Central Trust Co.*, 81 Md. 559; 32 Atl. 505; 29 L. R. A. Rep. 556 (as to priority between a railway mortgage and a lease of the railway executed at the same time).

³ *Manhattan Trust Co. v. Seattle*

§ 1904-§ 1912. RELATIVE RIGHTS OF THE BONDHOLDERS
AND OF OTHER PERSONS HAVING CLAIMS UPON AFTER-
ACQUIRED PROPERTY.

§ 1904. **Rights of Bona Fide Purchaser of After-acquired Property.** — As a charge of after-acquired property can only operate as an equitable as distinguished from a legal lien, it would follow that a purchaser for value who without notice of the charge should secure the legal title to real or personal property covered thereby would take discharged from the lien.¹ But as corporation mortgages are in America recorded, all the world has notice of them, so that every purchaser even of after-acquired property necessarily takes with constructive notice thereof.²

§ 1905. **Priority of Bondholders' Lien on After-acquired Property in general.** — In general, the effect of a charge of after-acquired property, or, to use a phrase current in America among the legal profession, of the after-acquired property clause, is to give a priority over all unsecured creditors, in respect to any after-acquired property that comes within the terms of the mortgage. The nature or the origin of the unsecured indebtedness is not material. For instance, a charge upon a railway to be thereafter constructed gives priority even over a debt incurred for its construction.³ The fact that the unsecured creditor's money, property, or labor has brought into existence property out of which the holder of the pre-existing charge may be paid gives him no equity sufficient to defeat the latter's preference. No principle analogous to the rules of priority in admiralty can be invoked to give a preference to the unsecured claim.

¹ *Roper v. Castell & Brown* (1898), (N. H.), 68 Atl. 410 (where it seems 1 Ch. 315; *English, etc. Investment Co. v. Brunton* (1892), 2 Q. B. 700; record would not operate as constructive notice).
Spinney v. Meloon (N. H.), 68 Atl. 410.

² *Dunham v. Cincinnati, etc. Ry. Co.*, 1 Wall. 254, 267 (headnote inadequate). Cf. *Columbus, etc. R. R. Co. Appeals*, 109 Fed. 177, 205 et seq.; 48 C. C. A. 275.

But see *Spinney v. Meloon*

³ *Galveston, etc. R. R. Co. v. Cowdrey*, 11 Wall. 459, 480-482.

But cf. *Chicago, etc. Ry. Co. v. Loewenthal*, 93 Ill. 433; *Smythe v. Chicago, etc. R. Co.*, 22 Fed. Cas. 711, No. 13,135.

§ 1906-§ 1912. *Of the Doctrine that Bondholders take After-acquired Property subject to any Liens existing thereon at the time of its Acquisition by the Company.*

§ 1906. **In general.** — On the other hand, bondholders must take after-acquired property subject to any liens or equities with which it is impressed when it comes into the company's hands.¹ Hence, where property is acquired by the company through fraud, the bondholders though innocent take subject to the defrauded party's right of reclamation.² So too, where on a purchase of chattels by a corporation a mortgage back is given to secure the purchase price, prior mortgage bondholders take the goods as after-acquired property subject to the lien of the vendor,³ although the latter's mortgage is unrecorded and therefore invalid against third persons generally.⁴ So, a vendor's lien upon land sold to the company after the execution of the mortgage and issue of the bonds will take precedence over the bonds.⁵ And on the same principle where a branch or lateral line of railway is conveyed to a railroad company in consideration of the

¹ See in addition to cases cited *infra*, *Coe v. Delaware, etc. R. R. Co.*, 34 N. J. Eq. 266. For a case in which the rights of a purchaser at a foreclosure sale were held to be superior in this respect to the rights of the bondholders under the mortgage which was foreclosed, see *Westinghouse Electric, etc. Co. v. New Paltz, etc. Co.*, 32 N. Y. Misc. 132; 65 N. Y. Supp. 644 (arising under a statute requiring such contracts to be recorded), *sed quære*.

² *Williamson v. New Jersey Southern R. R. Co.*, 29 N. J. Eq. 311, 318-322.

³ *Hand v. Savannah, etc. R. R. Co.*, 12 S. Car. 314, 364-465.

⁴ *United States v. New Orleans, etc. R. R. Co.*, 12 Wall. 362; *Fosdick v. Schall*, 99 U. S. 235, 250-251. See *infra*, § 1910.

⁵ *Loomis v. Davenport, etc. R. R. Co.*, 3 McCrary, 489; *Central Trust Co. v. Bridges*, 57 Fed. 753; 6 C. C. A. 539; *Harris v. Youngstown*

Bridge Co., 90 Fed. 322, 333-334; 33 C. C. A. 69; 93 Fed. 355; 35 C. C. A. 341 (where the vendor's lien was held to include sums paid by the vendor as consequential damages on account of the use to which the property was to be put by the corporation).

But see *Fisk v. Potter*, 2 Abb. Ct. App. Dec. (N. Y.) 138. Cf. *Venner v. Farmers' L. & T. Co.*, 90 Fed. 348; 33 C. C. A. 95 (where the vendor, being owner of all the shares of the company was held estopped from setting up any vendor's lien against the bondholders).

A claim for damages by a person whose land has been condemned for use by a railway company has, in some jurisdictions, priority over persons claiming under a previous mortgage to secure an issue of bonds. *Western Pa. R. R. Co. v. Johnston*, 59 Pa. St. 290. Cf. *Mercantile Trust Co. v. Pittsburgh, etc. R. R. Co.*, 29 Fed. 732. See also *infra*, § 1913.

latter's agreement to pay the grantor a certain proportion of the earnings of the branch road, the grantor's right to his due share of the earnings has priority over a mortgage previously given to secure an issue of bonds.¹ Moreover, second-mortgage bonds issued to pay for terminal facilities conveyed to a bridge corporation by a subsidiary company may have priority as to the property so conveyed over first-mortgage bonds previously issued by the bridge company.² *A fortiori*, where the company purchases goods under a contract by which the vendor is to retain title until the payment of the purchase price, the lien of prior bondholders attaches in subordination to the vendor's right to retake the property on default in payment of the price.³ So, where a so-called lease of personal property is made to a railway company, it is immaterial whether the transaction be deemed in law a lease or a conditional sale; for in either event the lessor, or vendor, is entitled to a return of the property, upon the company's insolvency, notwithstanding a prior mortgage covering after-acquired property.⁴

§ 1907. **Exception where the After-acquired Property is annexed to and made Part of Realty which is covered by the Bondholders' Mortgage.**—These principles have no application where the after-acquired property is annexed to realty which is covered by the bondholders' prior mortgage. For in such a case, the bondholders' rights are not derived from the after-acquired property clause, but from the common-law principle that chattels so annexed to the freehold as to become part of the realty belong to the owner thereof and are included in any lien thereon. For instance, if iron rails which were purchased by a railroad company under an agreement that the vendor should retain a lien for the price are fastened down upon land which is covered by a prior charge in favor of bondholders, the rails become in law part

¹ *Fidelity Ins., etc. Co. v. Norfolk, etc. R. R. Co.*, 72 Fed. 704.

² *Harris v. Youngstown Bridge Co.*, 90 Fed. 322; 33 C. C. A. 69; 93 Fed. 355; 35 C. C. A. 341.

³ *Fosdick v. Schall*, 99 U. S. 235; *Fosdick v. Car Co.*, 99 U. S. 256.

Cf. *Tilford v. Atlantic Match Co.*, 134 Fed. 924; *Washington Trust Co. v. Morse Iron Works*, 106 N. Y. App. Div. 195; 94 N. Y. Supp. 495 (where

the court ordered a sale of the property free from the vendor's claim, but decreed that he should have a preference out of the proceeds of sale).

⁴ *Myer v. Car Co.*, 102 U. S. 1; *McGourkey v. Toledo, etc. Ry. Co.*, 146 U. S. 536, 551–553; 13 Sup. Ct. 170 (semble); *Meyer v. Johnston*, 64 Ala. 603, 670–671; s. c., 53 Ala. 237.

of the freehold, and therefore the lien of the vendor will be postponed to that of the bondholders.¹ So, a contractor who constructs a railway under an agreement with the company that he shall retain possession of the road until paid must be postponed to bondholders claiming under a previous mortgage.² Indeed, the lien of the bondholders takes precedence of the lien of a vendor of personal property which is to be annexed to the freehold by the company, notwithstanding an express stipulation in the contract between him and the company that the chattels shall not be deemed to become part of the realty.³ These principles, however, have not met with universal acceptance.⁴

§ 1908. **Conditions of Application of the Doctrine — Necessity that the Lien on the After-acquired Property should actually and bona fide antedate Acquisition of Title by the Company.** — In order that a lien or charge upon property that is covered by an after-acquired property clause in a prior mortgage should have a preference over the bondholders upon the ground that the property when it came into the company's possession was already subject to the lien or charge in question, the rule is inexorable that the lien or charge must actually, substantially, and *bona fide* antedate or at least accompany the acquisition of title by the corporation. If the property passes to the company, for never so short a time, before the lien or charge attaches to it, the rights of the bondholders under their after-acquired property clause at once become paramount;⁵ and the court will strike down any disguise or sham intended to cover up the real nature of the transaction to the prejudice of the bondholders.⁶ Thus, although as shown above an owner of personal property may sell it to the

¹ *United States v. New Orleans v. White Water Valley R. R. Co.*, 12 Wall. 362 (semble); 132 U. S. 68; 10 Sup. Ct. 29; *Harris Hunt v. Bay State Iron Co.*, 97 Mass. 279. Cf. *Pierce v. Emery*, 32 N. H. 484, 520-522; *Wood v. Holly Mfg. Co.*, 100 Ala. 326 (headnote inadequate); 13 So. 948; 46 Am. St. Rep. 56.

For further illustration of the same principle, see *Phoenix Iron Works v. New York Security & Trust Co.*, 83 Fed. 757; 28 C. C. A. 76.

² *Dunkham v. Cincinnati, etc. Ry. Co.*, 1 Wall. 254, 267-268; *Thompson*

v. Youngstown Bridge Co., 90 Fed. 322, 331-332; 33 C. C. A. 69; 93 Fed. 355; 35 C. C. A. 341.

³ *New York, etc. Trust Co. v. Capital Ry. Co.*, 77 Fed. 529.

⁴ See *Western Union Tel. Co. v. Burlington, etc. R. R. Co.*, 3 McCrary 130.

⁵ *Knowles Loom Works v. Ryle*, 97 Fed. 730; 38 C. C. A. 494.

⁶ *Harris v. Youngstown Bridge Co.*, 90 Fed. 322; 33 C. C. A. 69; 93 Fed. 355; 35 C. C. A. 341.

corporation reserving a lien for the purchase price, or may, retaining the title, lease it to the company, and in either event his rights will be superior to previously issued mortgage bonds,¹ yet if instead of selling or leasing property to the company a person advances money to the corporation with which to acquire such property under an agreement that he shall have a lien thereon for his advance, he must be subordinated to antecedent mortgage bonds.² The title to the property passes to the corporation, and instantly the lien of the bondholders attaches. If the court comes to the conclusion the true facts are as stated above, it makes no difference that the written contract between the company and the lender may carefully provide that the company in purchasing the property shall be deemed his agent: the court will be governed by the real nature of the transaction rather than by what the parties for their own purposes may have chosen to call it.³ If the persons who enter into such a contract with the company are the directors thereof, the court will the more readily conclude that the real transaction was not what it was named by the parties.⁴

§ 1909. **Liens on After-acquired Property which originate after Acquisition of equitable Title but before Acquisition of legal Title by the Company.** — If the company acquires the full equitable title to certain property, the lien of antecedent mortgage bonds under their after-acquired property clause at once attaches, and the fact that before the company gets in the legal title a lien or charge has been created upon the property will not give that lien or charge precedence over the bonds.⁵ The acquisition of title for the purposes of the rule we are now considering occurs

¹ Supra, § 1906.

² *McGourkey v. Toledo, etc. Ry. Co.*, 146 U. S. 536; 13 Sup. Ct. 170.

But see *Frank v. Denver, etc. Ry. Co.*, 23 Fed. 123. Cf. *Farmers' L. & T. Co. v. Denver, etc. R. R. Co.*, 126 Fed. 46 (money advanced to a trustee for the corporation to pay off a prior lien and secured by a mortgage of the trust property held to have priority over previously issued bonds secured by a mortgage of after-acquired property).

³ *McGourkey v. Toledo, etc. Ry. Co.*, 146 U. S. 536; 13 Sup. Ct. 170.

Cf. *Hinchman v. Point Defiance Ry. Co.*, 14 Wash. 349; 44 Pac. 867.

⁴ *McGourkey v. Toledo, etc. Ry. Co.*, 146 U. S. 536; 13 Sup. Ct. 170. As to this case, see also supra, § 1646.

⁵ *Toledo, etc. R. R. Co. v. Hamilton*, 134 U. S. 296 (headnote inadequate); 10 Sup. Ct. 546.

See also *Central Trust Co. v. Kneeland*, 138 U. S. 414 (headnote inadequate); 11 Sup. Ct. 357; *Farmers' L. & T. Co. v. Denver, etc. R. R. Co.*, 126 Fed. 46.

when the company acquired the equitable title; and it is only liens or charges then subsisting to which the bonds are to be postponed. This principle cannot be invoked, however, to defeat the priority of a lien which was created by a subsidiary corporation upon its own property after a majority of its shares had been acquired by the mortgagor company;¹ for the owner of a majority of the shares in a corporation has no title, legal or equitable, to its property, and hence the property of the subsidiary corporation is not covered by the mortgage of the dominant company. So, where a landowner agrees to donate land to a railway company if the corporation will erect a station thereon, the company does not acquire even equitable title until the station has been constructed, and therefore a mechanic's lien for services rendered in building the station will take precedence over the lien of the company's previously issued bonds.² Of course, if after the company acquires the equitable title, the holder of the legal title sells the property to a *bona fide* purchaser, or creates a legal encumbrance upon it in favor of a *bona fide* lienor, the rights of the purchaser or lienor will have priority over the bonds; but on the other hand the possession of the property by the company may often be deemed to affect the purchaser or encumbrancer with notice of the company's equitable title, so as to give priority to the lien of the after-acquired property clause in the mortgage securing the bonds.³

§ 1910. **Effect of Failure to record Lien existing on After-acquired Property at Time of its Acquisition by Company.** — If property comes into the company's hands already subject to a charge or lien, which is valid against the company, but which because of want of registration would not be enforceable against *bona fide* purchasers, the bondholders claiming under an after-acquired property clause in an antecedent mortgage hold subject to the unrecorded charge or lien.⁴ The bondholders

¹ *Toledo, etc. R. R. Co. v. Hamilton*, 134 U. S. 296, 303-304; 10 Sup. Ct. 546 (semble); *Central Trust Co. v. Kneeland*, 138 U. S. 414, 428; 11 Sup. Ct. 357 (semble); *Williamson v. New Jersey Southern R. R. Co.*, 29 N. J. Eq. 311.

² *Botsford v. New Haven, etc. R. R. Co.*, 41 Conn. 454.

³ *Columbus, etc. R. R. Co. Appeals*, 109 Fed. 177, 205; 48 C. C. A. 275.

⁴ *U. S. v. New Orleans R. R. Co.*, 12 Wall. 362; *Fosdick v. Schall*, 99 U. S. 235, 250-251; *Myer v. Car Co.*, 102 U. S. 1; *Frank v. Denver, etc. Ry. Co.*, 23 Fed. 123; *Manhattan Trust Co. v. Sioux City Cable Ry. Co.*, 76 Fed. 658; *Daly v. New York*

succeed to such rights only as the company acquires; and the registration laws are "intended for the protection of subsequent, not prior, purchasers and creditors."¹ The spirit of the recording acts is so plainly in accord with this dictum that, although one can imagine a statute which would permit the holders of previously issued bonds to take advantage of the failure to record the lien or charge upon after-acquired property, yet very emphatic language would be necessary to induce the courts to place such a construction upon an act. Consequently, the bondholders will be subordinated to the unrecorded lien where the registration act provides: "unregistered charges and liens shall be void against any creditor or purchaser"² or "against any third party."³

§ 1911. *United Lines Telegraph Co. v. Boston Safe Deposit and Trust Co.* — The case of the *United Lines Telegraph Company v. Boston Safe Deposit & Trust Company*,⁴ which might present difficulties to a casual reader, is chiefly notable for complicated facts, rendered doubly intricate by a virtual absence of a headnote or other succinct statement. After one succeeds in finding his way through the multiform and involved transactions out of which the case arose, the decision is seen to contain no new propositions of law.

Reduced to their lowest terms, the facts are as follows: one telegraph company, which we may call the Bankers' Company, contracted to construct a line of telegraph for another telegraph company, called the Rapid Company, the consideration being mortgage bonds of the latter company covering all its property, present and future. The line was accordingly constructed with money obtained by the Bankers' Company from the issue of its own mortgage bonds. The court held that under the construction contract the title to the line so

etc. Ry. Co., 38 Atl. 202; 55 N. J. Eq. 595. Cf. *Wood v. Holly Mfg. Co.*, 100 Ala. 326; 13 So. 948; 46 Am. St. Rep. 56; *Loomis v. Davenport, etc. R. R. Co.*, 3 McCrary 489.

But see *Fisk v. Potter*, 2 Abb. Ct. App. Dec. (N. Y.) 138; *Guaranty Trust Co. v. Galveston City R. R. Co.*, 107 Fed. 311, 324; 46 C. C. A. 305.

¹ *U. S. v. New Orleans R. R. Co.*, 12 Wall. 362, 365.

² *Myer v. Car Co.*, 102 U. S. 1. Cf. *Newgass v. Atlantic, etc. Ry. Co.*, 56 Fed. 676.

³ *Fosdick v. Schall*, 99 U. S. 235, 250-251.

⁴ *United Lines Telegraph Co. v. Boston Safe Deposit & Trust Co.*, 147 U. S. 431; 13 Sup. Ct. 396.

Cf. *Chicago, etc. Ry. Co. v. Lowenthal*, 93 Ill. 433.

built vested at once in the Rapid Company, and that accordingly the holders of the Rapid Company's bonds had a better right thereto than the bondholders of the Bankers' Company.

The whole point of the decision is that the title, at least the equitable title, to the line of telegraph as it was constructed vested in the Rapid Company. Had the title first vested in the Bankers' Company, the lien of the bondholders of the Bankers' Company would have attached and taken precedence over the bonds of the Rapid Company, unless indeed the transfer of title from the Bankers' Company to the Rapid Company could be deemed a transaction within the implied power of the former company to deal with its property in ordinary course of business notwithstanding the prior issue of mortgage bonds.¹

§ 1912. "**Car Trusts.**" — The principles considered in the preceding paragraphs in respect to relative priorities as regards after-acquired property have found their most frequent exemplification in cases of so-called car trusts.² Indeed, most of the cases cited in the foregoing paragraphs were cases of car trusts. This circumstance, however, is a mere accident due to the fact that mortgage bonds have not been common in this country except for a comparatively short space of time save in the case of railway companies, and to the further fact that cars and other rolling stock are a form of personal property which is very costly and which every railroad must have. The necessity of acquiring rolling stock notwithstanding the existence of a preceding mortgage covering all after-acquired property, and the impossibility of procuring the rolling stock unless the purchase price should be made a lien having priority over the mortgage, have begotten the invention known as the car trust. The car trust, however, is nothing more than a lease or conditional sale of personal property. Its validity, therefore, so far as the attempt to give priority over the antecedent mortgage is concerned,

¹ See *infra*, § 1922.

² A "car trust" association is a partnership. *Ricker v. American L. & T. Co.*, 140 Mass. 346; 5 N. E. 284. As to the powers of "trustees" under a "car trust" agreement to bind the members of the association,

see *Humphreys v. N. Y., etc. R. R. Co.*, 121 N. Y. 435; 24 N. E. 695. *Quære*, whether a car trust can be created by or for a receiver. *Taylor v. Philadelphia, etc. R. R. Co.*, 9 Fed. 1.

depends upon the principles stated broadly above in relation to the acquisition by the company of any kind of property.

§ 1913. **Claims preferred by Statute over Bonds and Debentures.**

— Statutes, at any rate statutes in force at the time of the issue of mortgage bonds, may of course provide that certain liens or charges subsequently attaching to the mortgaged property shall have precedence over the bonds.¹ Whether or not such priority is given must in each case be determined by construction of the particular statute in question; and as such statutes are in derogation of the common law, they should be strictly construed.² Priority of this sort is often given to certain claims for taxes and public assessments levied against the company.³ Sometimes mechanics' liens are placed by the statute upon this preferential basis:⁴ but sometimes they are not.⁵ Where the mechanics' lien is entitled to priority, the preference is not defeated because the lienor may be a stockholder and because the corporation may have given a guarantee that certain public subscriptions

¹ See, in addition to cases cited below, *Traders' Nat. Bank v. Lawrence Mfg. Co.*, 96 N. Car. 298; 3 S. E. 363; *McKee v. Grand Rapids, etc. Ry. Co.*, 41 Mich. 274; 1 N. W. 873; 50 N. W. 469; *Newgass v. Atlantic, etc. Ry. Co.*, 56 Fed. 676 (debts for railway supplies); *Fidelity, etc. Co. v. Roanoke Iron Co.*, 81 Fed. 439 (debts for supplies furnished to a manufacturing company).

² *Fidelity Ins., etc. Co. v. Norfolk, etc. R. Co.*, 90 Fed. 175.

³ See *Marriage, Neave, etc. Co.* (1896), 2 Ch. 663; *First Nat. Bank v. Ewing*, 103 Fed. 168, 188-191; 43 C. C. A. 150 (penalty and interest allowed as preferred claim).

⁴ *Hassall v. Wilcox*, 130 U. S. 493; 9 Sup. Ct. 590; *Brooks v. Railway Co.*, 101 U. S. 443; *Traders' Nat. Bank v. Lawrence Mfg. Co.*, 96 N. Car. 298; 3 S. E. 363; *Jarvis v. State Bank*, 45 Pac. Rep. 505; 22

Colo. 309; *Hall v. Mullanphy Planing Mill Co.*, 16 Mo. App. 454; *Westinghouse Air Brake Co. v. Kansas City So. Ry. Co.*, 137 Fed. 26; 71 C. C. A. 1; *Van Frank v. Brooks*, 93 Mo. App. 412.

Cf. *Antietam Paper Co. v. Chronicle Pub. Co.*, 115 N. Car. 143; *Poland v. Lamoiville R. R. Co.*, 52 Vt. 144; *St. Paul Title, etc. Co. v. Diagonal Coal Co.*, 95 Iowa 551; 64 N. W. 606; *Hale v. Burlington, etc. Ry. Co.*, 13 Fed. 203. As to the necessity for complying with the statutory requirements by filing claims, etc., even when the company is in the hands of a receiver, see *First Nat. Bank v. Ewing*, 103 Fed. 168, 185-186; 43 C. C. A. 150.

Of course a mechanics' lien takes precedence of subsequently issued mortgage bonds. *Fox v. Seal*, 22 Wall. 424.

⁵ *Toledo, etc. R. R. Co. v. Hamilton*, 134 U. S. 296; 10 Sup. Ct. 543.

and grants would suffice to pay all such claims.¹ In some states, claims of property-owners for damages for property condemned by corporations take precedence over previously issued mortgage bonds;² and the same is true of claims of laborers and the like,³ or of claims for damages to person or property,⁴ or of judgments upon such claims.⁵

§ 1914-§ 1931. OF THE POWER OF THE COMPANY TO DEAL WITH ITS PROPERTY IN ORDINARY COURSE OF BUSINESS NOTWITHSTANDING PREVIOUS ISSUE OF MORTGAGE BONDS.

§ 1914. **Right of Company to Possession of the Property.**—The right to possession of the property covered by the mortgage or deed of trust of course remains in the company, at least until default in payment of bonds or coupons. This is usually the subject of express provision in the mortgage or deed of trust; but even without express provision to that effect the courts will spell out an intent that the company shall continue in possession.⁶ Any other hypothesis would be wholly at variance with the whole scheme on which corporation bonds or debentures are issued. An express stipulation in a railway mortgage that until default in interest shall have continued for a certain length of time the company shall have the right to possession of the road without “let, suit, interruption, disturbance, claim or demand whatso-

¹ *Meyer v. Hornby*, 101 U. S. 728. S. W. 537 (claims for “damage to persons”).

² *Mercantile Trust Co. v. Pittsburgh, etc. R. R. Co.*, 29 Fed. 732; *Central Trust Co. v. Louisville, etc. Ry. Co.*, 81 Fed. 772; *Fordyce v. Kansas City, etc. R. R. Co.*, 145 Fed. 566. Cf. *Zimmerman v. Kansas City, etc. R. Co.*, 144 Fed. 622; 75 C. C. A. 424. See *supra*, p. 1535, n. 5.

³ Cf. *Security Trust Co. v. Goble R. R. Co.*, 75 Pac. 697; 74 Pac. 919; 44 Oreg. 370. As to priority of such claims apart from statute, see *infra*, § 1932 et seq.

⁴ *Baltimore Trust, etc. Co. v. Hofstetter*, 85 Fed. 75; 29 C. C. A. 35; *Central Trust Co. v. East Tennessee, etc. Ry. Co.*, 70 Fed. 764; *Frazier v. Ry. Co.*, 88 Tenn. 138; 12

⁵ *Winter v. Iowa Central Ry. Co.*, 82 N. W. 760; 111 Iowa 342; *Guardian Trust, etc. Co. v. Fisher*, 200 U. S. 57; 26 Sup. Ct. 186 (where the judgment was rendered against a corporation which had purchased the property of the company which issued the bonds); *Central Trust Co. v. Central Iowa Ry. Co.*, 38 Fed. 889 (judgments for “injury to any person”); *Phinizy v. Augusta, etc. R. R. Co.*, 63 Fed. 922; *Southern Ry. Co. v. Bouknight*, 70 Fed. 442; 17 C. C. A. 181.

⁶ *Southern Pac. R. R. Co. v. Doyle*, 11 Fed. 253.

ever" by the mortgagee has been held not to prevent an action at law to recover an instalment of interest before the expiration of the stipulated period of default.¹

§ 1915-§ 1927. POWER OF COMPANY TO DISPLACE LIEN OF BONDS BY TRANSACTIONS IN ORDINARY COURSE OF BUSINESS.

§ 1915. **In general.** — Some power, which may be of greater or less extent, is almost invariably reserved to the company to displace the lien of mortgage bonds or debentures by transactions in the ordinary course of business. Where the property covered by the lien is limited — for example, certain specific chattels or a particular lot of ground — this power may conveniently be reduced to a minimum or even altogether dispensed with. The greater the extent of the property covered by the charge, the greater the necessity for a liberal power to enable the company in the ordinary course of its business to convey title free from the lien of the bondholders. Nevertheless, in most American corporation mortgages, this power is rather closely circumscribed — in the writer's opinion, too closely circumscribed. A liberal power of the sort can rarely do the bondholders any harm and may greatly promote the success of the company's business. More probably than not, the courts would in a proper case read into the mortgage an implied power of this kind of much greater extent than the express powers usually inserted in such instruments; but any such implied power is too uncertain to justify exclusive reliance upon it in the present state of the American authorities.

§ 1916-§ 1919. *In England.*

§ 1916. **General Statement of Powers reserved by Floating Charge.** — The maximum of liberality in powers of this sort is found in the English floating charge. While no power so extensive has yet been recognized in the United States, a tendency in

¹ *Northern Central Ry. Co. v.* not a mortgage securing an issue of State, 17 Md. 8 (note that this was a bonds).
mortgage securing an annuity, and

that direction is discoverable. We shall, therefore, consider as briefly as possible the extent of the extremely wide power reserved to the company by an English floating charge.

Under such a power, the company may do anything that can be deemed a transaction in the ordinary course of business, just as if the charge had never been created. For instance, profits earned by the company, although as after-acquired property they are subject to the charge, may nevertheless lawfully be distributed among the shareholders in the shape of dividends.¹ Even where the charge covers uncalled capital, the company may nevertheless forfeit shares for non-payment of calls.² So, the company may sell any portion of its property in regular course. For instance, a trading company all of whose property including its stock in trade is covered by a floating charge may sell the stock to its customers, and of course pass a title free of the charge. Indeed, the English courts have even held that a sale of the company's entire business in pursuance of a clause contained in the memorandum of association may be deemed a transaction in the ordinary course of business and therefore within the power of a corporation which has created a floating charge on its property and business,³ so that the lien of the debenture-holders would merely attach to the proceeds of sale; but these decisions seem contrary to the spirit of a floating charge.⁴ So, the company may use property covered by the floating charge in the payment of its unsecured debts. For the same reason, the right of one of the company's debtors to set off a sum owing to him by the company is not affected by the existence of a floating charge.⁵

§ 1917. **Judgments and Executions against the Company.**—Likewise, a confession of judgment in favor of an unsecured creditor is deemed a proceeding in the ordinary course of business.⁶ But where a judgment is recovered against the company

¹ *Bosanquet v. St. John D'el Rey Liskeard & Caradon Ry. Co.* (1903), *Mining Co.*, 77 L. T. 206. 2 Ch. 681.

² *Agency Land & Finance Co.*, 20 Times L. R. 41. ⁵ *Biggerstaff v. Rowatt's Wharf* (1896), 2 Ch. 93; *Edward Nelson & Co. v. Faber & Co.* (1903), 2 K. B. 367.

³ *Vivian & Co.* (1900), 2 Ch. 654; *Borax Co.* (1901), 1 Ch. 326. ⁶ *Wilmott v. London Celluloid Co.*, 34 Ch. D. 147.

⁴ *Cf. Hubbuck v. Helms*, 56 L. J. Ch. 536; *Yorkshire Ry. Wagon Co. v. Maclure*, 21 Ch. D. 309, 315;

in invitum and execution thereon levied upon goods which are subject to the floating charge, the proceeding, being adversary, cannot be deemed a dealing by the company in the course of business, and is therefore not within the power reserved in the floating charge: and hence the execution creditor takes subject to the lien of the debenture-holders.¹

The same law applies to a case of garnishment,² except that if the garnishee actually pays the debt to the garnishor before the floating security crystallizes, he will not be compelled to pay over again to the debenture-holders.³ Indeed, if the company in order to prevent a sale of its goods under a *fi. fa.* pays money to the sheriff who seized its goods, the money is deemed to be paid to the judgment creditor on account, who will be entitled to retain it as against the debenture-holders.⁴

§ 1918. **Power of Company to mortgage specific Assets in Priority to a previous Floating Charge.** — The power of the company to displace the lien of the floating charge has been carried to such a logical extreme in England that even a subsequent mortgage of specific assets — that is, as distinguished from a second floating charge — may be deemed a transaction in ordinary course of business, and hence will take priority over the earlier charge.⁵ This decision, however, seemed to put a dangerous power in the hands of the company; and accordingly, the custom sprang up of inserting in the debentures, or in the covering deed of trust, a provision that the power of the company to deal with the property subject to the floating charge shall not extend to the creation of any mortgage or charge ranking in priority to or *pari passu* with the floating charge. Such provisions have been construed in a number of cases, and the courts have evinced a disposition to confine them within the narrowest

¹ *Davey & Co. v. Williamson & Son* (1898), 2 Q. B. 194; *Opera, Lt'd* (1891), 3 Ch. 260; *Taunton v. Sheriff of Warwickshire* (1895), 2 Ch. 319; *Legg v. Mathieson*, 2 Giff. 71; *Wildy v. Mid-Hants Ry. Co.*, 18 L. T. 73; *Furness v. Caterham Ry. Co.*, 27 Beav. 358; *Simultaneous Printing Syndicate* (1901), 1 K. B. 771. Cf. *infra*, § 1924.

² *Robson v. Smith* (1895), 2 Ch. 118.

³ *Robinson v. Burnell's Vienna Bakery Co.* (1904), 2 K. B. 624.

⁴ *Wheatley v. Silkstone Coal Co.*, 29 Ch. D. 715; *Ward v. Royal Exchange Shipping Co.*, 58 L. T. 174; *Hubbard & Co.*, 68 L. J. Ch. 54; *Government Stock Investment Co. v. Manila Ry. Co.* (1897), A. C. 81.

⁵ *Norton v. Yates* (1906), 1 K. B. 112; *Cairney v. Back* (1906), 2

possible limits.¹ A provision of the sort does not prevent the company from raising money by a sale of personal property, the purchase price being payable in instalments from time to time as the exigencies of the company may demand.²

Even without any provision of this sort, a second floating charge must be subordinated to the former; and for this reason an assignment of all the company's present and future book debts which clearly recognizes the power of the company to carry on business in the ordinary way and is therefore a floating charge, is to be subordinated to a prior floating charge securing debenture-stock.³

§ 1919. **When Power of Company under a Floating Charge terminates — Crystallization of the Security.** — The power of the corporation under an English floating charge to deal with its property in the course of business continues until the charge becomes fixed or crystallized, as the phrase is. Until that time, the debenture-holders cannot by any shift prevent the company from exercising its power. For instance, where choses in action are covered by the floating charge, the company will not be debarred from exercising its power to deal with them in the course of business because the debenture-holders may have given notice of their claims to the debtor.⁴ Nothing, therefore, can be of greater importance to the holder of a floating charge than the determination of the events upon the happening of which the charge becomes crystallized. Only two events can safely be said invariably to work a crystallization of a floating security. When the company goes into liquidation, a floating charge at once becomes crystallized.⁵ The same result is wrought by the appointment of a receiver in an action by the debenture-holders to

¹ *Bruton v. Electrical Engineering Corp.* (1892), 1 Ch. 434; *Roper v. Castell & Brown* (1898), 1 Ch. 315; *English, etc. Investment Co. v. Brunton* (1892), 2 Q. B. 700; *Robson v. Smith* (1895), 2 Ch. 118; *Valletort Sanitary Steam Laundry Co.* (1903), 2 Ch. 654 (subsequent equitable mortgagee without notice of the clause postponed to the debentures); *Cox v. Dublin City Distillery Co.* (1906), 1 Ir. 446 (pledgee of personal property postponed to debentures); *Moore v. Peruvian Corp.* (1908), 1 Ch. 604.

² *Old Bushmills Distillery* (1897), 1 Ir. R. 489.

³ Cf. *Illingworth v. Houldsworth* (1904), A. C. 355.

⁴ *Robson v. Smith* (1895), 2 Ch. 118; *Ward v. Royal Exchange Shipping Co.*, 58 L. T. 174.

⁵ *Hodson v. Tea Co.*, 14 Ch. D. 859; *Roundwood Colliery Co.* (1897), 1 Ch. 373.

But cf. *New England R. Co. v. Carnegie Steel Co.*, 75 Fed. 54; 21 C. C. A. 219.

enforce their security;¹ but if the order of appointment requires him to give security before acting, the charge will not be crystallized until the security is given.² *A fortiori*, the mere institution of a suit by debenture-holders to enforce their security is not enough;³ and according to one case not even the appointment of a receiver will prevent agents of the company who have received no notice of his appointment from dealing with the property as if the charge did not exist.⁴ The phraseology of the instrument creating the charge may be such that default by the company in payment of principal or interest will immediately crystallize the security;⁵ but ordinarily, unless the language is very strong, there must be in addition some step at least towards enforcement of the security.⁶ Possibly, if the company ceases to be a going concern, even in some other way than by being wound-up or than through the appointment of a receiver, the charge would be crystallized.⁷

§ 1920-§ 1925. *In America.*

§ 1920. **In general.** — The extent to which in America a corporation may, by dealing with its property in the ordinary course of business, pass a title free and clear of the claim of the bondholders cannot be stated with certainty. Much would necessarily depend on the terms of the mortgage and of the bonds themselves. A limited express power might be held to exclude inferentially a wider power that might otherwise be implied. For example, corporation mortgages often provide that if a sale or other alienation of real estate covered by the mortgage becomes desirable the company shall have power, with the assent of the trustee of the mortgage, to make the transfer of title. Such a provision would naturally be held to negative by implication any power in the company alone to part with such property.

¹ 1 Lindley on Companies, 6th ed., 325.

Cf. *Farmers' L. & T. Co. v. Detroit, etc. R. R. Co.*, 71 Fed. 29.

² *Roundwood Colliery Co.* (1897), 1 Ch. 373.

³ *Hubbard & Co.*, 68 L. J. Ch. 54.

⁴ *Arauco Co.*, 79 L. T. 336.

⁵ *Horne v. Hellard*, 29 Ch. D. 736.

⁶ *Government Stock Investment Co. v. Manila Ry. Co.* (1897), A. C. 81; *Edward Nelson & Co. v. Faber & Co.* (1903), 2 K. B. 367.

⁷ *Hubbuck v. Helms*, 56 L. J. Ch. 536.

But see *Vivian & Co.* (1900), 2 Ch. 654; *Borax Co.* (1901), 1 Ch.

326.

§ 1921. **Express Powers.** — Indeed, express powers apparently intended to enable the company to displace, partially, the lien of the bonds have been very strictly construed by some American courts.¹ Thus, a provision in a railway mortgage that the company should have power to make leases of such parts of the property covered by the charge as they might desire was held to confer no power to make leases which should continue to operate after default and after the right of the trustees of the mortgage to take possession accrued.² On the other hand, a power reserved to the company of selling lands necessarily includes the power to pay the expenses of the sale out of the purchase money.³

§ 1922. **Implied Powers.** — Nevertheless, some power to carry on the company's ordinary business must be recognized in America as well as in England; and that power necessarily includes the power to do all things that carrying on the business in ordinary course necessarily implies, even though thereby the lien of the bondholders may be partially displaced.⁴ Said Mr. Justice Bradley, speaking for the Supreme Court of the United States, "It must be conceded that, until the mortgage was enforced by entry or judicial claim, the personal property of the railroad was subject to its disposal in the ordinary course of business."⁵ There is clearly no reason for confining the power to personal property. The only distinction between real and personal property in this respect is that there may be more difficulty in showing that a sale of real estate is made in the ordinary course of business.

Certain it is, however, that in America no implied power of the company to deal with the mortgaged property will permit the creation of a mortgage or charge upon any part thereof in priority to the previously issued bonds. The English courts would certainly not be followed in their ruling that a general

¹ As to Canadian law, see *Trusts & Guarantee Co. v. Abbott Mitchell, etc. Co.*, 11 Ont. L. R. 403.

² *Haven v. Adams*, 4 Allen (Mass.) 80.

³ *Nickerson v. Atchison, etc. R. Co.*, 17 Fed. 408.

⁴ *Pierce v. Emery*, 32 N. H. 484, 514-515 (semble).

⁵ *Union Trust Co. v. Morrison*, 125 U. S. 591, 609; 8 Sup. Ct. 1004. Perhaps, *United Lines Tel. Co. v. Boston, etc. Co.*, 147 U. S. 431 (head-note inadequate); 13 Sup. Ct. 396, is an illustration of this principle. See explanation of the case, *supra*, § 1911.

“floating” charge upon all the company’s property permits the company to create in ordinary course of business a mortgage or charge upon some specific asset in priority to the general charge. Upon this point, the American cases are very clear.¹

§ 1923. **Power of Trustee of Mortgage to consent to Dealings by the Company with the charged Property.** — The power of the company to dispose of property in the ordinary course of business is sometimes augmented by the power of the trustee of the mortgage to sanction dealings with the mortgaged property that would otherwise be impossible. Indeed, it has sometimes been thought that such a power in the trustee can be implied without express terms;² but it would seem that no power of the sort should be implied beyond the mere negative or passive power to decline to insist upon their strict rights in litigation in which the trustee is their representative. A clause in the mortgage directing the trustee to release such portions of the land covered by the lien as might be sold by the company does not enure to the benefit of a person who subsequently obtains a mechanic’s lien upon part of the property, so as to give his claim a priority over the bonds.³

§ 1924. **Priority of Execution against Company over previously issued Mortgage Bonds.** — In one respect the power of the company to subject its property to claims which shall take precedence over antecedent blanket mortgages is carried even further in some of the United States than in England. In the latter country,

¹ *Dunham v. Cincinnati, etc. Ry. Co.*, 1 Wall. 254; *Galveston R. R. Co. v. Cowdrey*, 11 Wall. 459; *Toledo, etc. R. R. Co. v. Hamilton*, 134 U. S. 296; 10 Sup. Ct. 546; *Pierce v. Emery*, 32 N. H. 484, 515; and many other cases, for some of which see *supra*, § 1907, § 1908. It should be noticed that in most of these cases the argument that the implied power of the company to carry on its business included a power to create mortgages upon specific assets taking precedence over the bonds and general mortgage was not advanced. Perhaps such an argument might originally have prevailed; now it is probably too late

to raise it. See, however, *Weetjen v. St. Paul, etc. R. R. Co.*, 4 Hun (N. Y.) 429.

Cf. *Ellis v. Boston, etc. R. R. Co.*, 107 Mass. 1 (holding that bonds secured by a mortgage on all the present and future property of a railway company have priority over the rights of an express company under a contract by which the amounts due by it to the railway for freight were to be applied in reduction of a debt owing by the railway to the express company.

² *Pierce v. Emery*, 32 N. H. 484, 521–522.

³ *Old Colony Trust Co. v. Standard Beet Sugar Co.*, 150 Fed. 677.

as already pointed out, an execution against the company even while it is a going concern is postponed to a floating charge.¹ On the other hand, the United States Supreme Court, whose lead many other courts naturally follow, has based a decision upon the proposition that the power of a railway company to deal with its personal property in the ordinary course of business necessarily involves the liability of such property to be taken on execution for its debts so long as it remains a going concern, as though the charge did not exist.² Even if some courts would dissent from this proposition,³ yet at all events, it would seem clear that the objection to an execution levied upon the company's property upon the ground that the same is covered by a mortgage or charge must be made by the bondholders or their representative and cannot be raised by the company.⁴

§ 1925. **No Power in Company to represent Bondholders in Litigation.** — Moreover, it is clear that the corporation does not in any sense represent the bondholders in litigation; and hence the bondholders are not bound by a judgment or decree in a

¹ *Supra*, § 1917.

² *Union Trust Co. v. Morrison*, 125 U. S. 591, 609; 8 Sup. Ct. 1004. Cf. *Clay v. East Tennessee, etc. R. R. Co.*, 6 Heisk. (Tenn.) 421; *Mississippi Valley, etc. Ry. Co. v. U. S. Express Co.*, 81 Ill. 534; *Brady v. Johnson*, 75 Md. 445, 450-454; 26 Atl. 49; 20 L. R. A. 737 (levy upon real property); *Roberts v. Denver, etc. R. R. Co.*, 8 Colo. App. 504; 46 Pac. 880; *Coe v. Knox County Bank*, 10 Oh. St. 412; *Coe v. Johnson*, 18 Ind. 218; *Parkhurst v. Northern Central R. R. Co.*, 19 Md. 472; 81 Am. Dec. 648; *Eells v. Johann*, 27 Fed. 327.

Under a mortgage of income, the earnings of the company are, while it continues a going concern, liable to be taken on execution by unsecured creditors, but for a different reason. See *supra*, § 1877.

As to levying upon the company's equity of redemption, see *Coe v. McBrown*, 22 Ind. 252; *St. Louis, etc. Ry. Co. v. Whitaker*, 68 Tex. 630; 5 S. W. 448; *Vicksburg, etc.*

R. R. Co. v. McCutchen, 52 Miss. 645.

³ See *Galena, etc. R. R. Co. v. Menzies*, 26 Ill. 121; *Dunham v. Isett*, 15 Iowa 284; *Phillips v. Winslow*, 18 B. Monr. (Ky.) 431; 68 Am. Dec. 729; *Philadelphia, etc. R. R. Co. v. Woelpper*, 64 Pa. St. 366 (headnote inadequate); 3 Am. Rep. 596; *Loudenslager v. Benton*, 4 Phila. 382; *Howe v. Freeman*, 14 Gray (Mass.) 566 (headnote inadequate); *Brainerd v. Peck*, 34 Vt. 496; *Ludlow v. Hurd*, 1 Disn. (Oh.) 552; *Dunham v. Earl*, 8 Fed. Cas. 41, No. 4, 149; *Coopers & Clark v. Wolf*, 15 Oh. St. 523; *First Nat. Bank v. Anderson*, 75 Va. 250; *Brady v. State*, 26 Md. 290; *Lane v. Baughman*, 17 Oh. St. 642; 93 Am. Dec. 653; *Buller v. Rahm*, 46 Md. 541.

⁴ *Boyd v. Chesapeake, etc. Canal Co.*, 17 Md. 195; 79 Am. Dec. 646.

But see *Roberts v. Denver, etc. Ry. Co.*, 8 Colo. App. 504; 46 Pac. 880.

suit against the company instituted after the issue of the bonds and execution of the covering deed of trust.¹

§ 1926. **Mortgage by Shipping Company — Power of Mortgagor to charter Vessels covered by Charge securing Series of Bonds.** — A mortgagor of a ship has, by general principles of English law, power to charter the vessel until the mortgagee takes possession; and any charter-party entered into by the mortgagor will bind the mortgagee.² *A fortiori* this principle would apply to a mortgage of a ship by an incorporated company to secure an issue of bonds or debentures. But the general principle is subject to the qualification that no contract entered into by the mortgagor can bind the mortgagee if it impairs his security — for example, if the vessel is chartered to sail to a blockaded port. This qualification has also been applied in a case where the mortgagor was a corporation and where the mortgage — which was a fixed as distinguished from a “floating charge” — secured a series of debentures.³

Of course, a mortgage by a shipping company to secure an issue of bonds would be subject to the power of the company or its representatives in charge of the vessels to create preferential maritime liens according to the ordinary rules of priority in admiralty.

§ 1927. **Whether Liberal Powers are deemed Fraudulent as against general Creditors.** — Powers of the utmost liberality, such as those implied in an English floating charge, may be vested in the company without risk of the mortgage or charge being held to be fraudulent as against other creditors.⁴ Thus, an

¹ *Farmers' L. & T. Co. v. Meridian Waterworks Co.*, 139 Fed. 661; 314.

Central Trust Co. v. Hennen, 90 Fed. 593; 33 C. C. A. 189; *Hassall v. Wilcox*, 130 U. S. 493; 9 Sup. Ct. 186.

590 (judgment for labor claims which under Texas statute would be entitled to priority over the mortgage bonds); *Keokuk, etc. R. R. Co. v. Missouri*, 152 U. S. 301; 14 Sup. Ct. 592; *Central Trust Co. v.*

Condon, 67 Fed. 84, 103; 14 C. C. A. 314. But cf. *Guardian Trust, etc. Co. v. Fisher*, 200 U. S. 57; 26 Sup. Ct. 186.

² *Carver's Carriage by Sea*, 3d ed., § 40.

³ *Law Guarantee, etc. Society v. Russian Bank* (1905), 1 K. B. 815.

⁴ *Supra*, § 1685 n., as to English floating charge. Cf. *Hasbrouck v.*

Ohio court said in answer to the contention that a deed of trust to secure an issue of bonds was invalidated by a clause which authorized the company, a railway company, to dispose of any part of the property that might not be necessary to the use of the road: "Where from the nature of the property pledged, it is indispensable that many portions of it should, from time to time, be repaired, reconstructed or renewed, there can be no impropriety in permitting the party who is bound to keep up the road and provide all things necessary to its use, to dispose of the old material, either in part payment of new appliances, or for its general preservation."¹ And in Maryland, the same doctrine has been even more emphatically laid down.² In this connection, we should observe that powers of this sort in corporation mortgages are conferred quite as much for the benefit of the bondholders as for the benefit of the company; for anything that hampers the company in carrying on its business prejudices the bondholders.

In a recent New York case where a manufacturing company, in mortgaging its stock in trade and other property in the ordinary form to secure an issue of bonds, attempted to reserve power to sell in the usual course of business, the proceeds of sale to be applied to any corporate purpose, the court held that the charge was ineffective as against a trustee in bankruptcy.³ The case proceeds upon the ground that the power of sale was reserved for the benefit of the company; but, as already stated,

Rich, 88 S. W. 131; 113 Mo. App. 389; *Re Burnham*, 140 Fed. 926; *New York Security Co. v. Saratoga Gas Co.*, 88 Hun (N. Y.), 569, 592-593; 34 N. Y. Supp. 890 (well-reasoned judgment), affirmed on opinion below, 157 N. Y. 689; 51 N. E. 1092; *Edelhoff v. Horner-Miller Mfg. Co.*, 86 Md. 595; 39 Atl. 314.

But see *Marine Construction, etc. Co.*, 144 Fed. 649; 75 C. C. A. 451; *Albes v. Keith, Simmons & Co.* (Ala.), 44 So. 693; *Standard Telephone & Electric Co.*, 157 Fed. 106 (as to law of Wisconsin).

¹ *Ludlow v. Hurd*, 1 Disn. (Oh.) 552. Cf. *Coopers & Clark v. Wolf*, 15 Oh. St. 523, 529 (headnote inadequate); *Jessup v. Bridge*, 11

Iowa 572, 575 (headnote inadequate); 79 Am. Dec. 513; *Buvinger v. Evening Union Printing Co.* (N. J.), 65 Atl. 482 (applying the same rule to choses in action as to tangible property — headnote inadequate).

But see *Thompson v. Huron Lumber Co.*, 4 Wash. 600; 30 Pac. 741; 31 Pac. 25.

² *Butler v. Rahm*, 46 Md. 541, 547-548, approved and followed in *Wylly-Gabbett Co. v. Williams* (Fla.), 42 So. 910, 929-930.

³ *Zartman v. First Nat. Bank*, 82 N. E. 127; 189 N. Y. 267, followed and applied in *Burmeister v. Koster*, 107 N. Y. Supp. 636 (mortgage by an individual trader).

it is submitted that this view is incorrect. Where would be the security of the bondholders if the company were obliged to stop business because the mortgage prevented any sale of property even in the ordinary course of trade? As a corporation mortgage covers the whole "undertaking" of the company, anything that enables that undertaking to be kept alive is for the benefit of the bondholders.

§ 1928. **Right of Bondholders or Trustee to interfere in the Management of the Company.** — The extent to which a bondholder, or the trustee for the bondholders, may have the aid of the courts in interfering with the management of the corporation and the use to which it shall put its property must depend largely upon the extent of the company's power to deal with the property in the course of business. The holder of an English floating charge would undoubtedly be held, until the charge crystallizes, to have no more right to interfere in the management of the company than any unsecured creditor. In the United States, where the company's powers are more limited, the bondholders' control might be somewhat greater.¹ For example, holders of railway bonds have successfully prosecuted a bill in equity to enjoin the company from complying with unreasonable schedules of rates prescribed by a railroad commission in violation of the constitutional rights of the railway company.² So, a bondholder has been allowed to maintain a bill to require a holder of a majority of the shares in the company to account for income which he had fraudulently diverted to his own use.³ The company will certainly be restrained by injunction from doing any act for

¹ *Newby v. Oregon Central R. R.* *Minton*, 120 Fed. 187; *Consolidated Co.*, 1 Sawy. 63 (an extreme case which would probably not be generally followed); *Weetjen v. St. Paul, etc. R. R. Co.*, 4 Hun (N. Y.) 529; *Currier v. New York, etc. R. Co.*, 35 Hun (N. Y.) 355; *Benson v. San Diego*, 100 Fed. 158; *Fidelity Trust Co. v. Hoboken, etc. R. Co.* (N. J.), 63 Atl. 273 (proceeding by the trustee).

Cf. *Illinois Trust, etc. Bank v.*

Water Co. v. City of San Diego, 89 Fed. 272; 92 Fed. 759; *Keystone Nat. Bank v. Palos Coal, etc. Co.* (Ala.), 43 So. 570.

² *Mercantile Trust Co. v. Texas, etc. Ry. Co.*, 51 Fed. 529.

³ *Linder v. Hartwell R. R. Co.*, 73 Fed. 320.

the purpose of injuring the security of the bondholders. Thus, where a deed of trust to secure an issue of bonds by a railway company, covers only that portion of the company's line lying between N and R, the bondholders may enjoin the company from constructing a new line "cutting off" that portion and diverting from it all lucrative business.¹ Moreover, the company may undoubtedly be enjoined from tampering with the security otherwise than in the ordinary prosecution of its business.² For instance, a railway company which has charged its roadway with the payment of an issue of bonds may be enjoined by any bondholder from tearing up the rails on any portion of the line and abandoning the same, even though that portion of the road is being operated at a loss.³

§ 1929-§ 1930. *Control of Company over Proceeds of Bonds.*

§ 1929. **In general.** — As a rule, the money raised by a corporation by the issue of bonds or debentures goes into the general funds of the company, so that the bondholders or debentureholders have no further concern with the application thereof except in so far as the lien of their mortgage may attach to any property acquired therewith.

§ 1930. **Under explicit Provisions as to Disposition of Proceeds of Bonds — Provisions for Exchange of Bonds for prior-lien Bonds.** — Sometimes, however, the bonds or the covering deed of trust contain express provisions as to the use to which the proceeds of the issue shall be put. For example, it may be provided that the proceeds shall be paid to the trustees of the mortgage to be disbursed only under their directions. In such a case, if the company's undertaking and business becomes impracticable and is abandoned, the bondholders may recover from the trustees any portion of the proceeds remaining in their hands unexpended,⁴ and this is true although only a minority of the bondholders ask a return of the money.⁵ Such portion of the fund as may be needed

¹ *Pullan v. Cincinnati, etc. senger R. R. Co.*, 1 Brewst. (Pa.) R. R. Co., 4 Biss. 35, 45-46 (head- 418.
note inadequate).

² Cf. *Fidelity Trust Co. v. Ho-* ⁴ *National Bolivian Nav. Co. v.*
boken, etc. R. Co. (N. J.), 63 Atl. *Wilson*, 5 A. C. 176.

273. ⁵ *Collingham v. Sloper* (1893),
2 Ch. 96.

³ *Watt v. Hestonville, etc. Pas-*

for reducing to a minimum the loss from the abandonment of the scheme may be devoted to that purpose before any part is returned to the bondholders.¹ If, however, the proceeds of the issue of the bonds are to be spent for some particular purpose by or under the direction of trustees any surplus remaining after the complete execution of that purpose should not be returned to the bondholders, but goes into the general funds of the company to be expended by it as it may see fit.²

Where the corporation, a railway company, covenants with the bondholders or their trustee to apply the proceeds of the issue to a particular purpose, such, for example, as the construction and operation of the railroad, a court of equity will intervene to enjoin a diversion to any other use;³ but if in violation of such a covenant the proceeds of the bonds are diverted to some other purpose, a person who subsequently purchases some of the bonds with knowledge of the completed diversion has no ground of complaint.⁴ Where the fund realized upon the issue of the bonds is deposited in bank by the company subject to the order of a building committee, the fund is impressed with a trust in favor of the bondholders to be applied only to the purposes stipulated for in the mortgage; and therefore in case of wrongful diversion of the money by the building committee, the trustee of the bondholders may unite with the corporation in a bill to hold liable the members of the committee and a person who connived with them in diverting the moneys.⁵

A provision contained in the bonds or debentures, or in the covering deed of trust, that certain of the bonds shall be issued in exchange for bonds of a prior series is very beneficial to the holders of other bonds of the new series, and doubtless at their instance a court of equity would enjoin the issue of such of the new bonds as the agreement relates to, for any other purpose. Such a provision, however, does not confer any rights upon the holders of the bonds of the former series, and they cannot compel

¹ *Collingham v. Sloper* (1893), following the proceeds of the bonds as trust funds see *Banque Franco-Egyptienne v. Brown*, 34 Fed. 162.

² *Van Weel v. Winston*, 115 U. S. 228, 246-247 (headnote inadequate); 6 Sup. Ct. 22.

⁴ *Belden v. Burke*, 147 N. Y. 542; 42 N. E. 261.

³ *Pennock v. Coe*, 23 How. 117, 129 (headnote inadequate). As to ⁵ *Basshor Co. v. Carrington*, 104 Md. 606.

the company to effect the exchange.¹ Similarly, a recital in a deed of trust securing an issue of bonds that a certain number of the bonds shall be used in paying off the existing indebtedness of the company does not create any trust in favor of the creditors or enable them to enforce the issue of those bonds to them.²

A provision that some of the bonds shall be issued only in exchange for bonds secured by a prior lien refers to living, enforceable bonds, and therefore the new bonds cannot be issued in exchange for bonds of the prior series which have been redeemed in pursuance of a sinking-fund provision contained in the prior mortgage.³

A covenant to create no charge on the proceeds of the bonds without the consent of the trustee of the bondholders is intended for the benefit of the bondholders and not of persons dealing with the company, so that the consent of the trustee to a contract of the company gives the contractor no lien on the proceeds of the bonds but merely enables the company, if it should so desire, to use those proceeds in paying him.⁴

§ 1931. **Effect of Condemnation for Public Use of Part of Property covered by Bondholders' Charge.**— Where the charge securing bonds or debentures is not a floating charge but covers certain specific property, the company having no power to sell or dispose of the mortgaged property without the assent of the bondholders or their trustees, it would seem clear that money payable for the condemnation of part of the property, or as compensation for restrictions on its use imposed by public authority, should be paid to the trustee of the covering deed.⁵ The fact that the company is by the terms of the charge entitled to possession of the mortgaged property will be recognized not by paying the money over to the company, but by ordering the trustee to invest the fund and pay over the income as received, to the company.⁶ The rule would doubtless be different in case of a mortgage of the entire business and undertaking.

¹ *Morse v. Chicago, etc. R. R. Co.*, 84 N. Y. App. Div. 406; 82 N. Y. Supp. 698. ⁴ *Dillon v. Barnard*, 21 Wall. 430.

² *Roanoke Street Ry. Co. v. Hicks, Mitcham, etc. Brewery Co.* (1906), 32 S. E. 295; 96 Va. 510. ⁵ *Law Guarantee & Trust Soc. v.*

³ *Havana Electric Ry. Co. v. Central Trust Co.*, 107 N. Y. Supp. 680. ⁶ *Law Guarantee & Trust Soc. v.*

§ 1932-§ 1958. UNSECURED CLAIMS AGAINST THE COMPANY WHICH ARE ENTITLED TO PRIORITY OVER MORTGAGE BONDS.

§ 1932. **In general — Rule in Fosdick v. Schall.** — To the natural and almost axiomatic rule, applicable alike to English floating charges and to American corporation mortgages, that when the security comes to be realized or the company wound-up, all unsecured debts must be postponed to the claims of the holders of the bonds or debentures, — to this rule, one important exception has become established in the United States. This exception is based upon the principle that when a corporation mortgages its business, or, to use an English term, its undertaking, laborers and others who keep the undertaking alive for the benefit of the mortgagee ought in equity to be paid out of the income of that undertaking or business which they have aided in preserving. The company in the exercise of its power of carrying on the business may, so long as it continues a going concern, devote to that purpose any “loose” property, particularly current earnings, even though covered by the general mortgage. The unsecured creditor, has, however, no legal right to insist upon the exercise of this power, and if the company is wound-up or goes into the hands of a receiver without this power being exercised, he has no redress at law. But the appointment of a receiver always rests more or less in the discretion of the chancellor, and he may attach such reasonable conditions as he chooses. Consequently, when bondholders pray the intervention of equity to assist them in enforcing their security, the chancellor, if he grant their prayer, will insist that the expenses of keeping the company a going concern for some time prior to the appointment of the receiver — usually six months¹ — shall be paid out of the income in preference even to the claims of holders of the mortgage bonds or coupons.² This is known as

Mitcham, etc. Brewery Co. (1906), *Breweries* (1907), 2 Ch. 359 (similar point). 2 Ch. 98.

Cf. *Noakes v. Noakes & Co.* ¹ As to this see *infra*, § 1951. (1907), 1 Ch. 64 (where the trustee Cf. *Central Trust Co. v. Thurman*, was allowed to apply the moneys 94 Ga. 735, 741.

in the purchase of other prop- ² *Fosdick v. Schall*, 99 U. S. erty); *Dawson v. Braime's Tadcaster* 235; *Sage v. Central R. R. Co.*,

the rule in *Fosdick v. Schall*, because in that case the doctrine was first clearly enunciated,¹ although the court concluded that in that particular case the conditions necessary for its application had not been established.

A reason sometimes assigned for the rule² is that the company is to be deemed the agent of the bondholders;³ but this theory has been generally, and most justly, disapproved.⁴

§ 1933. **To what Classes of Companies the Rule applies.** — The rule was first established in respect to railway companies, and in one case the United States Supreme Court threw out a query whether it could ever be applied to other corporations⁵ — particularly to corporations not engaged in public service. But the fact that a company is engaged in a public calling and that a cessation of its business might be a public calamity is no reason for divesting the contractual priority of private creditors⁶ unless

99 U. S. 334, 345 (headnote inadequate); *St. Louis, etc. R. R. Co. v. Cleveland, etc. Ry. Co.*, 125 U. S. 658, 673; 8 Sup. Ct. 1011 (semble); *Williamson's Adm'r v. Washington City, etc. R. R. Co.*, 33 Gratt. (Va.) 624; *Addison v. Lewis*, 75 Va. 701 (semble); *Drennen v. Mercantile Trust, etc. Co.*, 115 Ala. 592; 23 So. 164; 67 Am. St. Rep. 72; 39 L. R. A. 623; *Taylor v. Philadelphia, etc. R. R. Co.*, 7 Fed. 377; *Virginia, etc. Coal Co. v. Central R. R. Co.*, 170 U. S. 355; 18 Sup. Ct. 657.

Cf. *Miltenberger v. Logansport Ry. Co.*, 106 U. S. 286, 311; 1 Sup. Ct. 140; *Douglass v. Cline*, 12 Bush (Ky.) 608; *Poland v. Lamoiville Valley R. R. Co.*, 52 Vt. 144; *Duncan v. Trustees*, 3 Cent. L. J. 579; *Central Trust Co. v. Texas, etc. Ry. Co.*, 27 Fed. 178.

But see *Metropolitan Trust Co. v. Tonawanda, etc. R. R. Co.*, 103 N. Y. 245; 8 N. E. 488.

¹ In some cases in the federal courts previous to *Fosdick v. Schall*, efforts to obtain judicial sanction for some such rule had proved abortive. See *Denniston v. Chicago, etc. R. R. Co.*, 4 Biss. 414.

² For another reason which is

sometimes assigned for the rule and which is also submitted to be erroneous, see *infra*, § 1958.

³ Cf. *Lee v. Pennsylvania Traction Co.*, 105 Fed. 405.

⁴ *Hiles v. Case*, 9 Biss. 549, 550-551; 14 Fed. 141; *Blair v. St. Louis, etc. R. Co.*, 22 Fed. 471.

Cf. *Veatch v. American, etc. Trust Co.*, 79 Fed. 471; 25 C. C. A. 39; 84 Fed. 274; 28 C. C. A. 384.

⁵ *Wood v. Guarantee Co.*, 128 U. S. 416; 9 Sup. Ct. 131.

⁶ "The displacement of mortgage liens cannot be justified upon any line of reasoning which assumes that one class of creditors may be deprived of the benefits of their contract liens for the benefit of another upon the ground that the public interests are thereby subserved by the maintenance of a railway for the public convenience. Such a position antagonizes the constitutional principle that private property shall not be taken for the public benefit without compensation." *Gregg v. Mercantile Trust Co.*, 109 Fed. 220, 227-228; 48 C. C. A. 318; s. c. 124 Fed. 721; 59 C. C. A. 637; 197 U. S. 183; 25 Sup. Ct. 415.

general principles of equity, which apply with equal force to all kinds of corporations, justify the intervention. It is submitted that the query of the Supreme Court above referred to originated in alarm at the far-reaching consequences of the rule and at the danger of its misapplication or over-application; and that the rule should be not confined to railway companies.¹

§ 1934. **Rule not applicable unless Receiver appointed at Instance of Bondholders.** — The rule does not apply where the receiver is not appointed at the instance of the bondholders or their trustee, but at the suit of an unsecured creditor under an insolvency law or winding-up act.² *A fortiori*, it does not apply where a sale is had under a power contained in the deed of trust and without the appointment of a receiver;³ and the trustees of the mortgage have no right to give a preference to the supply claimants.⁴

§ 1935. **Effect of providing or failing to provide for the Preference in the original Decree appointing the Receiver — Power of the Court to reconsider its Action on subsequent Proceedings.** — From some authorities, one might conclude that the rule would not apply unless the preferential payment of the claims in question was stipulated for in the decree by which the receiver was ap-

¹ *Manhattan Trust Co. v. Seattle Coal, etc. Co.*, 16 Wash. 499; 48 Pac. 333, 737; *Drennen v. Mercantile Trust, etc. Co.*, 115 Ala. 592; 23 So. 164; 67 Am. St. Rep. 72; 39 L. R. A. 623 (a well-reasoned case overruling *Merchants' Bank v. Moore*, 106 Ala. 646; 17 So. 705); *Reynolds, etc. Co. v. Eacock*, 61 N. E. 732; 27 Ind. App. 459 (semble); *Le Hote v. Boyet*, 85 Miss. 636; 38 So. 1.

But see *Seventh Nat. Bank v. Shenandoah Iron Co.*, 35 Fed. 436; *Snively v. Loomis Coal Co.*, 69 Fed. 204; *Bound v. South Carolina Ry. Co.*, 50 Fed. 312 (a navigation company); *Security Trust Co. v. Goble R. R. Co.*, 74 Pac. 919; 75 Pac. 697; 44 Oreg. 370 (railway company engaged in lumber business); *First Nat. Bank v. Wyman*, 66 Pac. 456; 16 Colo. App. 468 (railway owned by a mining company and not used

by the public); *Manhattan Trust Co. v. Seattle Coal & Iron Co.*, 53 Pac. 951; 19 Wash. 493.

² *Central Trust Co. v. Thurman*, 94 Ga. 735, 740-746; 20 S. E. 141.

Cf. *Kneeland v. American Loan Co.*, 136 U. S. 89; 10 Sup. Ct. 950; *Southern Ry. Co. v. Carnegie Steel Co.*, 76 Fed. 492; 22 C. C. A. 289; *Reyburn v. Consumers' Gas Co.*, 29 Fed. 561; *New England R. Co. v. Carnegie Steel Co.*, 75 Fed. 54; 21 C. C. A. 219; *Street v. Maryland, etc. Ry. Co.*, 59 Fed. 25.

See also *Bound v. South Carolina Ry. Co.*, 47 Fed. 30 (where the bill was filed to foreclose a second mortgage).

³ *Louisville, etc. R. R. Co. v. Memphis Gaslight Co.*, 125 Fed. 97; 60 C. C. A. 141.

⁴ *Hollister v. Stewart*, 111 N. Y. 644, 661; 19 N. E. 782.

pointed;¹ but according to the weight of reason and authority the preferential payment may be provided for by any subsequent decree.² Conversely, a provision for a preference contained in the decree appointing the receiver, although it will protect the receiver for acting under it, may be contested by interested parties at any subsequent stage of the cause.³

§ 1936-§ 1940. *To what Funds the Preference extends.*

§ 1936. **Extension of the Preference to the Corpus of the Mortgaged Property in Cases of Diversion of Earnings to permanent Improvements or Payment of Interest on Bonds.** — This rule that a court of equity in a corporation receivership will devote the earnings to the payment in the first instance of the operating expenses for a short period prior to the receivership carries as a corollary the proposition that where such earnings have been diverted, whether by the corporation or the receiver, either to the payment of interest on the mortgage bonds or to permanent improvements which enure to the benefit of the bondholders, the creditors whose claims constitute operating expenses of the company for a short period prior to the receivership will have an equity to be paid in preference to the bondholders even out of the corpus of the estate to the extent of the amounts so

¹ *Central Trust Co. v. East Tennessee, etc. Ry. Co.*, 69 Fed. 658; *Mercantile Trust Co. v. Kings County, etc. Ry. Co.*, 40 N. Y. App. Div. 141; 57 N. Y. Supp. 892.

Cf. *Farmers' L. & T. Co. v. Northern Pacific R. R. Co.*, 74 Fed. 431, where the preference attaching to supply claims and the preference sometimes required as a condition of the appointment of a receiver were thought to be distinct in their origin. See also *Finance Co. v. Charleston, etc. R. R. Co.*, 62 Fed. 205; 10 C. C. A. 323; *Wood v. New York, etc. R. R. Co.*, 70 Fed. 741; *Cutting v. Taveres, etc. R. R. Co.*, 61 Fed. 150, 156; 9 C. C. A. 401; *Central Trust Co. v. Chattanooga, etc. R. R. Co.*, 69 Fed. 295; *Guarantee Trust, etc. Co. v. Phila-*

delphia, etc. R. Co., 52 N. Y. Supp. 116; 31 N. Y. App. Div. 511; *Finance Co. v. Charleston, etc. R. R. Co. (Moon, intervenor)*, 52 Fed. 526.

² *Atkins, etc. Co. v. Petersburg R. R. Co.*, 3 Hughes 307, 315-316; *Addison v. Lewis*, 75 Va. 701; *Clark v. Central R. R., etc. Co.*, 66 Fed. 803, 806 (headnote inadequate); 14 C. C. A. 112; *Blair v. St. Louis, etc. R. Co.*, 22 Fed. 471; *Central Trust Co. v. St. Louis, etc. Ry.*, 41 Fed. 551, 554.

³ *Fordyce v. Omaha, etc. R. R. Co.*, 145 Fed. 544 (affirmed as to one branch of the case in *Rodger Ballast Co. v. Omaha, etc. R. R. Co.*, 154 Fed. 629); *Atchison, etc. Ry. Co. v. Osborn*, 148 Fed. 606; 78 C. C. A. 378.

diverted.¹ It follows that an order of court making the operating expenses for a short period prior to the receiver's appointment a prior charge upon the income of the receivership is not revoked by a subsequent order authorizing the use of such income for permanent improvements to the property, but that the increased value of the property will be deemed to represent the income and will therefore be appropriated to payment of the operating expenses mentioned in the prior order.²

§ 1937. **What is such a Diversion of Earnings as will justify the Extension.** — Diversion of current income to the payment of interest on first-mortgage bonds does not, it has been held, justify the court in a suit for foreclosure of second-mortgage bonds, in charging the operating expenses on the proceeds of sale in preference to the second-mortgage bonds.³ And, of course, the diversion of money of some third party to payment of interest coupons instead of payment of labor claims, etc., for which latter purpose it was advanced, will not justify the court in making such labor claims a preferred charge on the corpus.⁴ It has been held that if current supplies are furnished to the company on credit,

¹ *Fosdick v. Schall*, 99 U. S. 235, 253-254 (semble); *Burnham v. Bowen*, 111 U. S. 776; 4 Sup. Ct. 675; *Williamson's Admr. v. Washington City, etc. R. R. Co.*, 33 Gratt. (Va.) 624; *Addison v. Lewis*, 75 Va. 701 (semble); *Drennen v. Mercantile Trust, etc. Co.*, 115 Ala. 592; 23 So. 164; 67 Am. St. Rep. 72; 39 L. R. A. 623; *Clark v. Central R. R., etc. Co.*, 66 Fed. 803; 14 C. C. A. 112; *Calhoun v. St. Louis, etc. Ry. Co.*, 14 Fed. 9; *Southern Ry. Co. v. Carnegie Steel Co.*, 176 U. S. 257; 20 Sup. Ct. 347; *Virginia Coal Co. v. Central R. R., etc. Co.*, 170 U. S. 355; 18 Sup. Ct. 657; *Van Frank v. Mo. Pac. Ry. Co.*, 89 Mo. App. 460; *Gregg v. Mercantile Trust Co.*, 109 Fed. 220; 48 C. C. A. 318 (payment of car-trust certificates), with which case cf. s. c. on subsequent appeal and certiorari, 124 Fed. 721; 59 C. C. A. 637; 197 U. S. 183; 25 Sup. Ct. 415.

Cf. *Skiddy v. Atlantic, etc. R. R. Co.*, 3 Hughes 320; *Farmers, etc.*

Bank v. Waco Electric Ry. Co., 36 S. W. Rep. 131 (Tex.); *Dow v. Memphis, etc. R. R. Co.*, 20 Fed. 260, 267. As to use of income of a leased line of railway in payment of interest on the lessor's bonds instead of payment of operating expenses, see *Southern Ry. Co. v. Tillett*, 76 Fed. 507; 22 C. C. A. 303; *Grand Trunk Ry. Co. v. Central Vt. R. Co.*, 78 Fed. 690.

² *Union Trust Co. v. Souther*, 107 U. S. 591, 595 (headnote inadequate); 2 Sup. Ct. 295.

³ *St. Louis, etc. R. R. Co. v. Cleveland, etc. Ry. Co.*, 125 U. S. 658, 676 (headnote inadequate); 8 Sup. Ct. 1011; *Central Trust Co. v. East Tennessee, etc. R. R. Co.*, 80 Fed. 624; 26 C. C. A. 30.

⁴ *Wood v. Guarantee Trust Co.*, 128 U. S. 416, 420-421 (headnote inadequate); 9 Sup. Ct. 131; *Morgan's etc. Co. v. Texas Central Ry. Co.*, 137 U. S. 171 (headnote inadequate); 11 Sup. Ct. 61.

the creditor must have contemplated that until the expiration of the credit the earnings would be devoted to the payment of interest on the bonded debt, and consequently such use of earnings during the period for which credit was given will not justify the court in making such supply claims a prior charge on the corpus.¹ It is immaterial whether the diversion of income was accomplished by the company, by the receiver for the bondholders, or by a receiver appointed at the instance of the general creditors or of shareholders or of the company itself.² But a supply claimant can have no benefit from a diversion of income which took place before his claim was contracted.³

§ 1938. **Amount of Diversion.** — Even where a diversion of income by the receiver is proved, it will not avail the supply claimants if the deficit on the income account is so great that even if no such diversion had occurred still no net income would have been available for payment of their claims.⁴ If the amount of income diverted from current expenses is once made good — for example, by issuing receiver's certificates and applying the proceeds towards defraying the operating expenses — the supply creditors have no further preference,⁵ since their priority is limited to the amount of the diversion.

§ 1939. **Whether the Preference should ever be extended to Corpus without Proof of Diversion of Earnings.** — In some cases the preference has been extended to the corpus of the property without proof of diversion of income. Notably, the United States Circuit Court of Appeals for the Fourth Circuit, Mr. Chief Justice Fuller delivering the opinion of the court, once so held.⁶ Per-

¹ *Bound v. South Carolina Ry. Co.*, 145 Fed. 544, 562 (affirmed as to one branch of the case in *Rodger Co.*, 58 Fed. 473; 7 C. C. A. 322.

Cf. *Westinghouse Air Brake Co. v. Kansas City So. Ry. Co.*, 137 Fed. 154 Fed. 629).
27; 71 C. C. A. 1.

² *Virginia, etc. Coal Co. v. Central R. R. Co.*, 170 U. S. 355, 370 (headnote inadequate); 18 Sup. Ct. 657.

³ *Kansas Loan, etc. Co. v. Electric Ry., etc. Co.*, 108 Fed. 702, 703 (headnote inadequate); *Fordyce v. Omaha, etc. R. R. Co.*, 145 Fed. 544 (affirmed as to one branch of the case in *Rodger Ballast Co. v. Omaha, etc. R. R. Co.*, 154 Fed. 629).

⁴ *Fordyce v. Omaha, etc. R. R.* See also *Cutting v. Taveres, etc.*

haps this decision can be supported on the ground that the preference in question had been provided for in the decree by which the receiver was appointed, and had been acquiesced in by all parties. At all events, it is submitted that the whole theory of the law is opposed to extending the preference to the corpus of the property without proof of diversion of income, and that the courts generally would unquestionably reach that conclusion, as indeed the Supreme Court of the United States has done in a very important and recent case.¹ Moreover, in a large number of cases, the preference had been denied on the ground that diversion of income had not been proved.²

§ 1940. **Whether the Preference extends to Earnings of Receiver without Proof of Diversion.**—In some cases it has been held that the preference attaching to claims within the rule in *Fosdick v. Schall* extends only to such income as was earned by the company prior to the receivership, unless some diversion of that income be proved, and that, for the purposes of the present rule, income earned after the appointment of the receiver should stand on the same footing as the corpus of the estate, so that the

R. R. Co., 61 Fed. 150; 9 C. C. A. 401; *New England R. Co. v. Carnegie Steel Co.*, 75 Fed. 54; 21 C. C. A. 219; *St. Louis, etc. R. R. Co. v. O'Hara*, 177 Ill. 525; 52 N. E. 734; 53 N. E. 118.

¹ *Gregg v. Metropolitan Trust Co.*, 197 U. S. 183 (headnote inadequate); 25 Sup. Ct. 415, with which compare s. c. in Circuit Court of Appeals, 109 Fed. 220; 48 C. C. A. 318; and 124 Fed. 721; 59 C. C. A. 637.

See also to the same effect: *Rhode Island Locomotive Works v. Continental Trust Co.*, 108 Fed. 5; 47 C. C. A. 147; *International Trust Co. v. Townsend Brick, etc. Co.*, 95 Fed. 850; 37 C. C. A. 396; *Cambridge Iron Co. v. Union Trust Co.*, 55 N. E. 745 (headnote inadequate); 56 N. E. 665; 154 Ind. 291; 48 L. R. A. 41; *Fordyce v. Omaha, etc. R. R. Co.*, 145 Fed. 544 (affirmed as to one branch of the case in *Rodger Ballast Co. v. Omaha, etc. R. R. Co.*, 154 Fed. 629); *Hammerly v.*

Mercantile Trust, etc., 26 So. 646; 123 Ala. 596; *Waters-Pierce Oil Co. v. U. S., etc. Trust Co.* (Tex.), 99 S. W. 212.

² *St. Louis, etc. R. R. Co. v. Cleveland, etc. Ry. Co.*, 125 U. S. 658; 8 Sup. Ct. 1011; *Quincy, etc. R. R. Co. v. Humphreys*, 145 U. S. 82, 103-104; 12 Sup. Ct. 787; *Hunt & Bro. v. Memphis, etc. Co.*, 95 Tenn. 136; 31 S. W. 1006; *Fidelity, etc. Ins. Co. v. Shenandoah Valley R. R. Co.*, 86 Va. 1, 11; 9 S. E. 759; 19 Am. St. Rep. 858; *Blair v. St. Louis R. Co.*, 25 Fed. 232; *Southern Ry. Co. v. Carnegie Steel Co.*, 73 Fed. 492; 22 C. C. A. 289; *U. S. Trust Co. v. New York, etc. R. Co.*, 25 Fed. 800 (headnote misleading).

See also *Coe v. New Jersey Midland Ry. Co.*, 31 N. J. Eq. 105, 128-133; *Blair v. St. Louis, etc. R. Co.*, 22 Fed. 471; *Central Trust Co. v. Chattanooga, etc. R. R. Co.*, 69 Fed. 295; *Van Frank v. St. Louis, etc. Ry. Co.*, 89 Mo. App. 489, 499.

preference of the holders of claims for operating expenses should extend to such income only when it might be extended to the corpus.¹ This doctrine, however, seems to have been discarded by the courts; and it is now held that earnings of the receivership stand on the same footing as earnings of the company before the appointment of the receiver, and may be devoted to payment of claims which are within the rule in *Fosdick v. Schall*, even without proof of diversion.²

§ 1941-§ 1951. *What Claims are entitled to Preference under the Rule.*

§ 1941. **In general — Only claims for Operating Expenses within the Rule.** — In order that a claim may be brought within the protection of the rule in *Fosdick v. Schall*, it must be strictly a claim for operating expenses.³ The equity of the unsecured

¹ *Farmers' L. & T. Co. v. Northern Pac. R. R. Co.*, 68 Fed. 36, 38-39.

² *Farmers' L. & T. Co. v. Vicksburg, etc. R. R. Co.*, 33 Fed. 778, 784-785; *Virginia, etc. Coal Co. v. Central R. R., etc. Co.*, 170 U. S. 355; 18 Sup. Ct. 657; *Union Trust Co. v. Souther*, 107 U. S. 591 (headnote inadequate); 2 Sup. Ct. 295. Cf. *Douglas v. Cline*, 12 Bush (Ky.) 608.

³ "The appointment of a receiver vests in the court no absolute control over the property, and no general authority to displace vested contract liens. Because in a few specified and limited cases this court has declared that unsecured claims were entitled to priority over mortgage debts, an idea seems to have obtained that a court appointing a receiver acquires a power to give such preference to any general and unsecured claims. It has been assumed that a court appointing a receiver could rightfully burden the mortgaged property for the payment of any unsecured indebtedness. Indeed, we are advised that some courts have

made the appointment of a receiver conditional upon the payment of all unsecured indebtedness in preference to the mortgage liens sought to be enforced. Can anything be conceived which more thoroughly destroys the sacredness of contract obligations?" *Kneeland v. American Loan Co.*, 136 U. S. 89, 97; 10 Sup. Ct. 950. Cf. *Duncan v. Mobile, etc. R. R. Co.*, 2 Woods 542.

But see *Farmers' L. & T. Co. v. Northern Pac. R. R. Co.*, 74 Fed. 431 (where the court conceded — erroneously, it would seem — that the payment of other claims than operating expenses might be made a condition of the appointment of a receiver).

As to what constitutes operating expenses, see in addition to cases cited in succeeding notes, *Manhattan Trust Co. v. Sioux City Cable Ry. Co.*, 76 Fed. 658, 660-661 (headnote inadequate); *Southern Ry. Co. v. Carnegie Steel Co.*, 176 U. S. 257, 286-290; 20 Sup. Ct. 347; *Van Frank v. St. Louis, etc. Ry. Co.*, 89 Mo. App. 489; *Atlantic Trust Co. v. Woodbridge Canal, etc. Co.*, 86 Fed. 975, and also *infra*,

creditors grows out of the concurrent character of income and operating expenses, and out of the equitable principle that the preferred right of the bondholders should attach only to the *net* income.²

§ 1942. **Claims for making Permanent Improvements.** — The courts have repeatedly held that a claim for original construction of a railroad does not stand on the same footing in this respect as a claim for its operation or maintenance.³ To be sure, in a number of dicta, claims for making "permanent improvements" to the mortgaged property have been said to stand on the same footing as claims for labor and supplies, but these dicta would seem to be inconsistent with the actual decisions above referred to as to claims for original construction, and have accordingly been disapproved.⁴ Hence, a debt incurred in the purchase of permanent equipment, such as a locomotive or a large lot of new rails for a railway company, has been held not to fall within the preferential class.⁵

§ 2048. Authority given to a receiver to compromise and settle claims against the company gives him no right to pay such claims in full in preference to the mortgage bonds. *Mercantile Trust Co. v. Baltimore, etc. R. R. Co.*, 79 Fed. 389.

² *Fosdick v. Schall*, 99 U. S. 235, 251-252; *Union Trust Co. v. Souther*, 107 U. S. 591; 2 Sup. Ct. 295; *Meyer v. Johnston*, 64 Ala. 603, 671; *Addison v. Lewis*, 75 Va. 701; *Central Trust Co. v. Utah Central Ry. Co.*, 50 Pac. 813; 16 Utah 12; *Pickering v. Townsend* (Ala.), 23 So. 703; 118 Ala. 351.

³ *Hale v. Frost*, 99 U. S. 389 (headnote inadequate); *Wood v. Guarantee Trust Co.*, 128 U. S. 416; 9 Sup. Ct. 131; *Porter v. Pittsburg Bessemer Steel Co.*, 120 U. S. 649, 671; 7 Sup. Ct. 741; *Toledo, etc. R. R. Co. v. Hamilton*, 134 U. S. 296; 10 Sup. Ct. 546; *Barstow v. Pine Bluff, etc. Ry. Co.*, 21 S. W. Rep. 652; 57 Ark. 334; *Addison v. Lewis*, 75 Va. 701, 714-715 (headnote inadequate); *American, etc. Trust Co. v. East and West R. Co.*,

46 Fed. 101; *St. Louis, etc. Ry. Co. v. Continental Trust Co.*, 111 Fed. 669; 49 C. C. A. 529; *First Nat. Bank v. Ewing*, 103 Fed. 168, 186-187; 43 C. C. A. 150; *Farmers' L. & T. Co. v. Stuttgart, etc. R. R. Co.*, 92 Fed. 246; *Ten Eyck v. Pontiac, etc. R. R. Co.* (Mich.), 72 N. W. 362; 114 Mich. 494.

Cf. *Reyburn v. Consumers' Gas, etc. Co.*, 29 Fed. 561 (holding that a debt incurred in the completion of a gas company's works is not within the protection of the rule).

⁴ *Illinois Trust, etc. Bank v. Doud*, 105 Fed. 123; 44 C. C. A. 389; 52 L. R. A. 481; *Maryland Steel Co. v. Gettysburg Electric Ry. Co.*, 99 Fed. 150 (rebuilding of plant destroyed by fire); *International Trust Co. v. Townsend Brick, etc. Co.*, 95 Fed. 850; 37 C. C. A. 396 (rebuilding old bridge).

It has been held that a debt incurred for furnishing a waiting-room and ticket-office for a railway company is entitled to a preference. *Northern Pac. R. Co. v. Lamont*, 69 Fed. 23; 16 C. C. A. 364.

⁵ *Manchester Locomotive Works v.*

§ 1943. **Miscellaneous Claims.** — The rule in *Fosdick v. Schall* has been applied, however, in favor of debts due from the mortgagor company — a railway company — to other companies for ticket and freight balances,¹ and in favor of the claim for reimbursement of one who, to prevent the company's property from being seized on execution, goes surety for the company on an appeal bond.² It seems that a claim of the company's solicitor and counsel for his compensation is within the rule,³ but

Truesdale, 44 Minn. 115; 46 N. W. 301; 9 L. R. A. 140; *Lackawanna etc. Co. v. Farmers' L. & T. Co.*, 176 U. S. 298 (headnote inadequate); 20 Sup. Ct. 363; *Gregg v. Mercantile Trust Co.*, 109 Fed. 220; 48 C. C. A. 318 (cf. s. c. on subsequent appeal and certiorari, 124 Fed. 721; 59 C. C. A. 637; 197 U. S. 183; 25 Sup. Ct. 415); *Rhode Island Locomotive Works v. Continental Trust Co.*, 108 Fed. 5; 47 C. C. A. 147; *McCornack v. Salem, etc. Ry. Co.*, 56 Pac. 518; 34 Oreg. 543 (improved machinery for electric railway plant); *Morgan's, etc. Co. v. Farmers' L. & T. Co.*, 79 Fed. 210; 24 C. C. A. 495; *Rodger Ballast Car Co. v. Omaha, etc. R. Co.*, 154 Fed. 629 (price of ballast cars purchased for making extraordinary repairs).

Cf. *Fidelity Ins., etc. Co. v. Shenandoah Valley R. R. Co.*, 86 Va. 1; 9 S. E. 759; 19 Am. St. Rep. 858; *Niles Tool Works v. Louisville, etc. Ry. Co.*, 112 Fed. 561; 50 C. C. A. 390.

Debts incurred for ordinary repairs as distinguished from new improvements of course fall within the protection of the rule. *Southern Ry. Co. v. Tillett*, 76 Fed. 507; 22 C. C. A. 303; *Southern Ry. Co. v. Carnegie Steel Co.*, 176 U. S. 257; 20 Sup. Ct. 347.

¹ *Miltenberger v. Logansport Ry. Co.*, 106 U. S. 286, 311; 1 Sup. Ct. 140; *Finance Co. v. Charleston, etc. R. R. Co.*, 62 Fed. 205; 10 C. C. A. 323; *Van Frank v. Mo. Pac. Ry. Co.*, 89 Mo. App. 460; *Gregg v. Mercantile Trust Co.*, 109 Fed. 220;

48 C. C. A. 318 (cf. s. c. on subsequent appeal and certiorari, 124 Fed. 721; 59 C. C. A. 637; 197 U. S. 183; 25 Sup. Ct. 415).

² *Union Trust Co. v. Morrison*, 125 U. S. 591; 8 Sup. Ct. 1004. Cf. *Rome, etc. R. R. Co. v. Sibert*, 97 Ala. 393; 12 So. 69 (the case of a surety on a bond given upon an appeal from an award in a condemnation case); *Farmers' L. & T. Co. v. Northern Pac. R. R. Co.*, 71 Fed. 245 (headnote inadequate); *Jones v. Central Trust Co.*, 73 Fed. 568; 19 C. C. A. 569.

But see *Central Trust Co. v. Wabash, etc. R. Co.*, 24 Fed. 98; *Farmers' L. & T. Co. v. Northern Pac. R. R. Co.*, 68 Fed. 36; *Whiteley v. Central Trust Co.*, 76 Fed. 74; 22 C. C. A. 67; 34 L. R. A. 303; *New York, etc. Trust Co. v. Louisville, etc. R. R. Co.*, 79 Fed. 386.

³ *Gurney v. Atlantic, etc. Ry. Co.*, 58 N. Y. 358; *Bayliss v. Lafayette, etc. Co.*, 9 Biss. 90 (headnote misleading); *Blair v. St. Louis, etc. Ry. Co.*, 23 Fed. 521. Cf. *Finance Co. v. Charleston, etc. R. R. Co.*, 52 Fed. 526; *Blair v. St. Louis, etc. R. Co.*, 20 Fed. 351; *Mercantile Trust Co. v. Missouri, etc. Ry. Co.*, 41 Fed. 8.

Aliter as to lawyers' fees earned in particular cases under special employment. *Gregg v. Mercantile Trust Co.*, 109 Fed. 220, 225-226; 48 C. C. A. 318 (cf. s. c. on subsequent appeal and certiorari, 124 Fed. 721; 59 C. C. A. 637; and 197 U. S. 183; 25 Sup. Ct. 415).

it is perhaps otherwise as to the claim of the company's president for his salary.¹ A claim for repayment of advances made to defray operating expenses is entitled to no preference.² And a claim against the company for personal injuries or damage to property caused by negligence or breach of duty on the part of the company in the conduct of its business shortly before the receivership has likewise no title to a preference under the rule in *Fosdick v. Schall*;³ and the same thing is true of a claim for damages for breach of a contract by a railway company to receive lumber at a certain point.⁴ A claim incurred for advertising is not entitled to preference.⁵ The protection of the rule has been refused to claims for rental of cars, or of lines of railway or even of terminal facilities, accruing prior to the receivership;⁶ but some at least of these decisions are difficult to support

¹ *National Bank of Augusta v. Am. St. Rep.* 379; 33 L. R. A. 806
Carolina, etc. R. R. Co., 63 Fed. 25. (distinguished in *Seaboard Air Line*
Cf. Addison v. Lewis, 75 Va. 701, *Ry. v. Knickerbocker Trust Co.*, 125
 712-713 (headnote inadequate). Ga. 463; 54 S. E. 138).

² See *infra*, § 1947.

⁴ *Central Trust Co. v. Wabash, etc. Ry. Co.*, 32 Fed. 566.

³ *Farmers' L. & T. Co. v. Detroit, etc. R. R. Co.*, 71 Fed. 29;
Hiles v. Case, 9 Biss. 549; 14 Fed. 141;
Easton v. Houston, etc. Ry. Co., 38 Fed. 12;
Central Trust Co. v. East Tennessee, etc. Ry. Co., 30 Fed. 895;
Farmers' L. & T. Co. v. Green Bay, etc. Ry. Co., 45 Fed. 664;
Farmers' L. & T. Co. v. Detroit, etc. R. R. Co., 71 Fed. 29;
Farmers' L. & T. Co. v. Northern Pac. R. Co., 74 Fed. 431;
New York, etc. Trust Co. v. Louisville, etc. R. R. Co., 79 Fed. 386;
Veatch v. American, etc. Trust Co., 79 Fed. 471;
 25 C. C. A. 39; 84 Fed. 274;
 28 C. C. A. 384;
Farmers' L. & T. Co. v. Northern Pac. R. R. Co., 79 Fed. 227;
Re Dexterville, etc. Boom Co., 4 Fed. 873;
Atlantic Trust Co. v. Dana, 128 Fed. 209;
 62 C. C. A. 657;
Hampton v. Norfolk, etc. Ry. Co., 127 Fed. 662;
Front St., etc. Ry. Co. v. Drake, 84 Fed. 257;
Atchison, etc. Ry. Co. v. Osborn, 148 Fed. 606;
 78 C. C. A. 378;
St. Louis Trust Co. v. Riley, 70 Fed. 32.

⁵ *Central Trust Co. v. East Tennessee, etc. R. R. Co.*, 80 Fed. 624;
 26 C. C. A. 30. *Cf. Queen Anne's Ferry, etc. Co. v. Queen Anne's R. Co.*, 148 Fed. 41.

⁶ *Thomas v. Western Car Co.*, 149 U. S. 95, 110-111; 13 Sup. Ct. 824;
Central Trust Co. v. Charlotte, etc. R. R. Co., 65 Fed. 264;
New York, etc. R. R. Co. v. New York, etc. R. R. Co., 58 Fed. 268;
Mather Humane, etc. Co. v. Anderson, 76 Fed. 164;
 22 C. C. A. 109;
Grand Trunk Ry. Co. v. Central Vt. R. Co., 90 Fed. 163;
Pullman's, etc. Co. v. American, etc. Co., 84 Fed. 18;
St. Louis, etc. Ry. Co. v. Continental Trust Co., 111 Fed. 669;
 49 C. C. A. 529;
Gregg v. Mercantile Trust Co., 109 Fed. 220;
 48 C. C. A. 318 (cf. s. c. on subsequent appeal and certiorari, 124 Fed. 721;
 59 C. C. A. 637;
 197 U. S. 183;
 25 Sup. Ct. 415);
Louisville, etc. R. R. Co. v. Central Trust Co., 87 Fed. 500;
 31 C. C. A. 89.

But see *Green v. Coast Line R. R. Co.*, 97 Ga. 15; 24 S. E. 814;
54 Shenandoah Valley R. R. Co., 86

on principle and are not easy to reconcile with other cases, and moreover appear to have been due to a reaction from the extreme position taken by some courts rather than to any clear principle.¹

§ 1944. **In Cases where separate Portions of Company's Property are covered by separate Mortgages.** — Where different portions of the company's property are covered by separate mortgages, securing distinct issues of bonds, operating expenses incurred in the prosecution of the company's business as a whole and constituting, under the rule in *Fosdick v. Schall*, claims having priority over the bonds must be borne by the several divisions of the company's property in such proportions as may be just. No hard and fast rule of apportionment can be laid down.²

§ 1945. **Preference not always dependent on the Question whether the Supplies were furnished under Contract with Mortgagor Company.** — In order that the supply creditors should be protected by the rule in *Fosdick v. Schall*, it is not always necessary that the supplies should be furnished under a contract with the mortgagor company but rather that they should be used for the maintenance of the mortgagor company.³ For instance, where a railway company has leased its railway to another corporation, persons who furnish the lessee company with current supplies used in operating the leased railway may be protected by the Rule as against holders of bonds of the lessor;⁴ and, conversely, such creditors have no equitable priority over the holders of the bonds of the lessor company whose security does not include

Va. 1; 9 S. E. 759; 19 Am. St. Rep. 858; *Fosdick v. Schall*, 99 U. S. 235; *Fosdick v. Car Co.*, 99 U. S. 256; *Terre Haute, etc. R. Co.*, 102 Fed. 825; 42 C. C. A. 654 (where the earnings of the leased line were held in trust for payment of rent which was therefore entitled to priority). The fact that by the terms of the lease rent accruing prior to the receivership is not payable until afterwards is no reason for giving it a priority over the mortgage bonds. *Mather Humane, etc. Co. v. Anderson*, 76 Fed. 164; 22 C. C. A. 109.

¹ *St. Louis, etc. R. R. Co. v.*

O'Hara, 177 Ill. 525; 52 N. E. 734; 53 N. E. 118 (preference for car rentals allowed); *Manhattan Trust Co. v. Sioux City, etc. Ry. Co.*, 102 Fed. 710 (preference for rental of terminal facilities allowed).

² *Central Trust Co. v. Wabash, etc. Ry. Co.*, 30 Fed. 332.

³ But cf. *Exchange Bank v. Macon Construction Co.*, 97 Ga. 1; 25 S. E. 326; 33 L. R. A. 800.

⁴ *Virginia, etc. Coal Co. v. Central R. R., etc. Co.*, 170 U. S. 355, 368; 18 Sup. Ct. 657; *Stewart v. Wisconsin Central R. Co.*, 95 Fed. 577. Cf. *Ruhlender v. Chesapeake, etc. R. Co.*, 91 Fed. 5; 33 C. C. A. 299.

the leased property.¹ In the ordinary case, however, it is undoubtedly necessary for a supply claimant to make out a valid claim against the company before he can have a preference over the bondholders. In other words, a mere volunteer who has furnished supplies cannot demand a preference.

§ 1946. **Interest on Preferential Claims.** — The preference extends to interest on sums due for operating expenses as well as to the principal of the indebtedness.²

§ 1947. **Rights of Assignee of Preferential Claims.** — An assignee of a claim which is within the rule in *Fosdick v. Schall* is entitled to the same preference as the original owner;³ but, as stated above,⁴ one who advances money to pay off debts for operating expenses is not subrogated to the equitable preference.⁵

¹ *Southern Ry. Co. v. Ensign Mfg. Co.*, 117 Fed. 417; 54 C. C. A. 591; *Southern Ry. Co. v. Chapman Jack Co.*, 117 Fed. 424; 54 C. C. A. 598.

² *Southern Ry. Co. v. Carnegie Steel Co.*, 76 Fed. 492; 22 C. C. A. 289 (affirmed, 176 U. S. 257; 20 Sup. Ct. 347); *Southern Ry. Co. v. Adams*, 76 Fed. 504; 22 C. C. A. 300; *Southern Ry. Co. v. American Brake Co.*, 76 Fed. 505; 22 C. C. A. 298. Cf. *Southern Ry. Co. v. Dunlop Mills*, 76 Fed. 505; 22 C. C. A. 302.

But see *Calhoun v. St. Louis, etc. Ry. Co.*, 14 Fed. 9, 11 (headnote inadequate); *New England R. Co. v. Carnegie Steel Co.*, 75 Fed. 54, 59; 21 C. C. A. 219.

³ *Union Trust Co. v. Walker*, 107 U. S. 596; 2 Sup. Ct. 299; *Burnham v. Bowen*, 111 U. S. 776; 4 Sup. Ct. 675; *Drennen v. Mercantile, etc. Trust Co.*, 115 Ala. 592; 23 So. 164; 67 Am. St. Rep. 72; 39 L. R. A. 623; *Northern Pac. R. R. Co. v. Lamont*, 69 Fed. 23; 16 C. C. A. 364.

Cf. *Cogan v. Conover Mfg. Co.* (N. J.), 60 Atl. 408 (where a preference created by statute was denied to assignee of claim).

⁴ *Supra*, § 1943.

⁵ *Morgan's, etc. Co. v. Texas Central Ry. Co.*, 137 U. S. 171; 11 Sup. Ct. 61; *Fidelity Ins., etc. Co. v.*

Shenandoah Valley R. R. Co., 86 Va. 1, 16-17; 9 S. E. 759; 19 Am. St. Rep. 858; *Farmers' L. & T. Co. v. Bankers, etc. Telegraph Co.*, 148 N. Y. 315; 42 N. E. 707; 51 Am. St. Rep. 690; 31 L. R. A. 403; *Southern Development Co. v. Farmers' L. & T. Co.*, 79 Fed. 212; 24 C. C. A. 497; *United States Trust Co. v. Western Contract Co.*, 81 Fed. 455; 26 C. C. A. 472; *Farmers' L. & T. Co. v. Vicksburg, etc. R. R. Co.*, 33 Fed. 778, 785.

Cf. *Penn v. Calhoun*, 121 U. S. 251; 7 Sup. Ct. 906; *First Nat. Bank v. Wyman*, 66 Pac. 456; 16 Colo. App. 468; *Exchange Bank v. Macon Construction Co.*, 97 Ga. 1; 25 S. E. 326; 33 L. R. A. 800 (where the money was advanced to the sole stockholder in the corporation).

But see *Manhattan Trust Co. v. Sioux City Cable Ry. Co.*, 76 Fed. 658 (headnote inadequate); *Atkins & Co. v. Petersburg R. R. Co.*, 3 Hughes 307; *Ames v. Union Pac. Ry. Co.*, 74 Fed. 335 (where a receiver paying off debts incurred by the company for operating expenses was subrogated to the priority); *Continental Trust Co. v. Toledo, etc. R. Co.*, 93 Fed. 532 (where the note was guaranteed by a third person).

§ 1948. **Effect of taking security for Claim, obtaining Judgment thereon, etc.** — The protection of the rule in *Fosdick v. Schall* is not waived or lost by taking or renewing commercial paper as evidence of the claim,¹ or by obtaining judgment against the company upon the claim;² but if the claimant accepts bonds of the company as collateral security, it has been held that he thereby recognizes their priority and waives his right to a preference under the rule in *Fosdick v. Schall*.³

§ 1949. **Rights of a Claimant who is under Obligation to pay the Bonds.** — It seems that the Rule will not be enforced in favor of a person who is under obligation himself to pay the mortgage bonds. For example, where the bonds have been guaranteed by a corporation which owns and controls another corporation, which latter company furnishes current supplies to the mortgagor company, the claim for the price of the supplies will not receive any preference at the hands of a court of equity.⁴

§ 1950. **Rights of Claimant who is entitled to a Mechanics' Lien.** — The equitable right to a preference under the doctrine of *Fosdick v. Schall* may be claimed by a creditor who is claiming simultaneously a preferred mechanics' lien covering the same debt: he cannot be required to elect between his equitable preference and his mechanics' lien.⁵

§ 1951. **Date of Claim as affecting Preference under the Rule in Fosdick v. Schall.** — The usual practice is to extend the benefit of the rule in *Fosdick v. Schall* to those claims only which ac-

¹ *Burnham v. Bowen*, 111 U. S. 776; 4 Sup. Ct. 675; *Southern Ry. Co. v. Carnegie Steel Co.*, 176 U. S. 257 (headnote inadequate); 20 Sup. Ct. 347.

But see *Brown v. New York, etc. R. R. Co.*, 19 How. Pr. (N. Y.) 84. Cf. *Ford v. Central Trust Co.*, 70 Fed. 144; 17 C. C. A. 31; *Guaranty Trust Co. v. Galveston, etc. R. R. Co.* 107 Fed. 311, 320-321; 46 C. C. A. 305. As to the effect of giving credit in suspending the right to avail of diversion of income, see supra, § 1937.

² *Central Trust Co. v. Clark*, 81 Fed. 269; 26 C. C. A. 397.

³ *Addison v. Lewis*, 75 Va. 701, 714 (headnote inadequate). Cf.

Fidelity Ins., etc. Co. v. Shenandoah Valley R. R. Co., 86 Va. 1, 17-18; 9 S. E. 759; 19 Am. St. Rep. 858; *Lackawanna, etc. Co. v. Farmers' L. & T. Co.*, 176 U. S. 298, 316 (headnote inadequate); 20 Sup. Ct. 363.

But see *Finance Co. v. Charleston, etc. R. R. Co.*, 62 Fed. 205; 10 C. C. A. 323.

⁴ *Guarantee Trust etc. Co. v. Philadelphia, etc. R. Co.*, 52 N. Y. Supp. 116; 31 N. Y. App. Div. 511.

⁵ *Westinghouse Air Brake Co. v. Kansas City So. Ry. Co.*, 137 Fed. 26; 71 C. C. A. 1. Cf. *Atlantic Trust Co. v. Woodbridge Canal, etc. Co.*, 86 Fed. 975.

crued within six months prior to the appointment of the receiver.¹ But there is no hard and fast rule on this point: the matter rests within the discretion of the court. In some cases the protection of the rule in *Fosdick v. Schall* has been accorded to much staler claims.²

§ 1952. **Effect of Misuse of Income by the Company.** — The equity of a current supply claimant, under the doctrine of *Fosdick v. Schall*, is not destroyed by the fact that net income to an amount exceeding his claim was misappropriated by the company and diverted to purposes which do not enure to the benefit of the mortgage bondholders.³ The supply claimant is no more responsible than the bondholders for the company's misuse of its funds. If the supply claimants were in any degree responsible for the use which the company may make of its income, the fact that the company has diverted income to payment of interest on the bonds or to permanent improvements would not justify an extension of the preference to the corpus of the mortgaged property.

§ 1953. **Nature of Preference — Preferred Claimant not a Secured Creditor.** — A claim which is entitled to a preference under the doctrine of *Fosdick v. Schall* is not by virtue of that doctrine made a lien in any true sense. For example, the holder of such a claim has no more right than any other general creditor to

¹ *Westinghouse Air Brake Co. v. Frank v. Mo. Pac. Ry. Co.*, 89 Mo. Kansas City So. Ry. Co., 137 Fed. 26; App. 460, 479 (headnote inadequate); 71 C. C. A. 1; *Southern Ry. Co. v. New York Guaranty Co. v. Tacoma Chapman Jack Co.*, 117 Fed. 424; *Ry. Co.*, 83 Fed. 365; 27 C. C. A. 550; *Guaranty Trust Co. v. Galveston Central Trust Co. v. Utah Central City R. R. Co.*, 107 Fed. 311, 320-321; *Ry. Co.*, 50 Pac. 813; 16 Utah 12 46 C. C. A. 305; *Central Trust Co. v. (claim two years old); Northern East Tennessee, etc. R. R. Co.*, 80 Pac. R. R. Co. v. Lamont, 69 Fed. 23; Fed. 625; 26 C. C. A. 30; *Blair v. 16 C. C. A. 364; Farmers' L. & T. St. Louis, etc. R. R. Co.*, 23 Fed. 521; *Co. v. Kansas City, etc. R. R. Co.*, Blair v. St. Louis, etc. R. R. Co., 22 53 Fed. 182; *Hale v. Frost*, 99 U. S. Fed. 471; Short's Law of Railway 389 (three years).

Bonds and Mortgages, § 620, § 621. Cf. *Brown v. New York, etc. R. R. Co.*, 19 How. Pr. (N. Y.) 84.
² *Williamson's Adm'r v. Washington City, etc. R. R. Co.*, 33 Gratt. ³ *Virginia, etc. Coal Co. v. Central (Va.)* 624, 640; *Scuthern Ry. Co. v. R. R., etc. Co.*, 170 U. S. 355, 365; *Carnegie Steel Co.*, 176 U. S. 257, 18 Sup. Ct. 657.
292-296; 20 Sup. Ct. 347; *Van*

have a receiver for the company appointed.¹ The preference is a mere windfall enjoyed by the grace of a court of equity.

§ 1954. **Waiver by Bondholders of their Priority over Claims not within the Rule in *Fosdick v. Schall*.** — Of course, a claim that is not within the protection of the rule in *Fosdick v. Schall* may be entitled to priority over the bonds if all the bondholders waive their preference in its favor.² But the mere fact that a claim against the company was contracted at the request of the bondholders and enured to their benefit will not amount to such waiver, and will not prevent or estop the bondholders from asserting the priority of their lien.³

§ 1955. **Effect of paying under erroneous Order of Court Claims that are not entitled to Preference.** — The fact that claims not properly within the rule in *Fosdick v. Schall* may have been paid out of income of the receivership will not justify the court in directing the amount of such claims to be deducted from the funds applicable to payment of claims that are properly entitled to a preference under that rule, but the loss from the improper payment must fall on the bondholders.⁴ If this decision be sound, the bondholders are to be held responsible for errors of the receiver and of the court. There is much to be said in favor of the view that such diversion of income by the receiver should not justify an extension of the supply claimants' preference to the corpus; that in order to have that effect, a diversion of income must enure to the benefit of the bondholders.

§ 1956. **Claims which have Priority even over Supply Claims.** — Some claims, such as debts due to the sovereign, may have priority even over the operating expenses which under the rule in *Fosdick v. Schall* take precedence over the bonds. If any such paramount claims are paid with moneys to which the bondholders have a first claim, the bondholders to the extent of such payment are entitled to be subrogated to the priority of such paramount claims over the operating expenses.⁵

¹ *Putnam v. Jacksonville, etc. Ry. Co.*, 61 Fed. 440.

³ *Kelly v. Receiver*, 10 Biss. 151.

² *Kelly v. Receiver*, 10 Biss. 151, 156 (semble). Cf. *Reinehart v. Augusta, etc. Co.*, 94 Fed. 901; 36 C. C. A. 541; *Queen Anne's Ferry, etc. Co. v. Queen Anne's, etc. R. R. Co.*, 148 Fed. 41.

⁴ *Grand Trunk Ry. Co. v. Central Vt. R. R. Co.*, 88 Fed. 620.

⁵ Cf. *Farmers' L. & T. Co. v. Detroit, etc. R. R. Co.*, 71 Fed. 29.

§ 1957. **Rule in *Fosdick v. Schall* peculiar to the United States — Not recognized in England.** — Finally, the doctrine of *Fosdick v. Schall* should be noted to be peculiar to the United States. No similar rule has ever gained a footing in England, or, so far as the reports disclose, ever been contended for in an English court.¹ The only approach to it is found in the statutory priority of "working expenses" in an English railway receivership.² English judges have, however, noticed the injustice which arises from the failure of their courts to give a preference to claims for operating expenses of the company over debentures secured by a floating charge.³

§ 1958. **Power of Court to direct preferential Payment of Arrears of Wages, etc., where Non-payment would be injurious to the Business — Distinction between this Doctrine and Rule in *Fosdick v. Schall*.** — The doctrine of *Fosdick v. Schall* is sometimes said to rest upon the ground that unless claims of laborers and other employees are paid in full they will most probably quit the service of the receiver with disastrous results to the business. Considerations of that sort may, indeed, under some circumstances justify the court in directing certain claims to be paid in full; but the doctrine of *Fosdick v. Schall* would seem to rest on independent grounds. For example, where a railway company has a contract with a telegraph company which is revocable at the will of either party, the court may, upon a threat of the telegraph company to terminate the agreement unless a balance due from the railway company at the time it went into the hands of a receiver is paid, direct the receiver, at his own instance, to pay the claim in full in order to prevent the great inconvenience and expense that would result from the termination of the contract between the two companies.⁴ So, the court may order income of the receivership to be used in paying interest on junior liens instead of on the first-mortgage bonds where exceptional circumstances render such payment greatly to the advantage of all concerned.⁵ So, a receiver may sometimes be directed to

¹ As to the Canadian law, see *Gooderham v. Toronto, etc. Ry. Co.*, 8 Ont. App. 685; *Wallbridge v. Farwell*, 18 Can. Sup. Ct. 1.

² See *infra*, § 2048. Cf. *Eastern & Midlands Ry. Co.*, 45 Ch. D. 367, 386.

³ *London Pressed Hinge Co.* (1905), 1 Ch. 576.

⁴ *Newgass v. Atlantic, etc. Ry. Co.*, 72 Fed. 712.

⁵ *Park v. New York, etc. R. R. Co.*, 64 Fed. 190. Cf. *Cleveland, etc. R. R. Co. v. Knickerbocker Trust Co.*, 61

pay an employee compensation for injuries which he sustained in the line of his duties but for which he has no enforceable cause of action against either the company or the receiver, if such gratuitous payment is good policy.¹ But this principle differs in many respects from the doctrine of *Fosdick v. Schall*. The former principle applies only when upon consideration of all the circumstances the court concludes that the payment of a claim in full would save the bondholders, in the end, more than it would cost them. The latter applies irrespective of the interests of the bondholders, being the equitable right of the supply creditors.

Fed. 623; *Lloyd v. Chesapeake, etc. Ry. Co.*, 33 Fed. 701; *Missouri R. R. Co.*, 65 Fed. 351; *Phinizy v. Pac. Ry. Co. v. Texas Pac. Ry. Co.*, *Augusta, etc. R. R. Co.*, 62 Fed. 771. 41 Fed. 319; *Thomas v. East Ten-*

¹ *Missouri Pac. Ry. Co. v. Texas, nessee, etc. Ry. Co.*, 60 Fed. 7.

CHAPTER XXX

BONDS AND MORTGAGES (CONTINUED) — ENFORCEMENT OF THE SECURITY

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§ 1959-§ 1964. ENFORCEMENT BY THE PARTIES WITHOUT
JUDICIAL AID.

§ 1959. **In general.** — An ordinary mortgagor of land or personal property has legal rights which he can exercise by taking possession of the mortgaged property and otherwise. In the case of a corporation mortgage or deed of trust, many difficulties would beset the bondholders in seeking to enforce their security out of court, unless some special powers be given to them or their trustee. Probably, the trustee might take possession of the property without any express authority in the deed of trust; but he would not be likely to do so.

§ 1960. **In England — Appointment of "Receiver" by Debenture-holders.** — In England, debentures or covering deeds of trust often vest in the debenture-holders a power to appoint a "receiver" to take possession of the property covered by the charge and to manage the business in the interest of the debenture-holders. Such a so-called "receiver" is of course quite distinct in his duties, powers, rights, and liabilities from a receiver appointed by a court of equity. Sometimes, indeed, the debentures contain a clause that the receiver appointed by the debenture-holders shall be deemed the agent of the company; and indeed this will be implied if he is empowered to carry on business in the name of the company.¹ In the absence of such provisions the "receiver" is the agent of the persons by whom he was appointed — that is, the debenture-holders.² If the instruments provide that such a receiver shall be the agent of the company, he does not become the agent of the debenture-holders or their trustee when the corporation is wound up, and his power to bind it is therefore terminated.³

The English courts display a commendable disposition to give full effect to powers of debenture-holders to appoint a receiver; and if the debenture-holders so desire, they may work out their own salvation through the instrumentality of such receivers without any judicial interference. While the courts recognize their own power to appoint a receiver and thus to oust the "receiver"

¹ *Owen & Co. v. Cronk* (1895), *Robinson Printing Co. v. Chic* (1905), 1 Q. B. 265. 2 Ch. 123.

² *Vimbos, Ltd* (1900), 1 Ch. 470; ³ *Gosling v. Gaskell* (1897), A. C. 575.

appointed by the debenture-holders, and although in any case of fraud — for example, where the “receiver” is acting in the interests of the shareholders rather than of the debenture-holders — they will not hesitate to exercise their jurisdiction,¹ yet they decline wantonly to interfere merely to vindicate their own power to override the contracts of the parties.² Hence, the debenture-holders’ power to appoint a receiver persists even after the company has been thrown into liquidation; and, although a “receiver” so appointed cannot take possession from the liquidator without leave of court, yet the necessary permission will ordinarily be granted almost as a matter of course.³

§ 1961-§ 1964. *In America — Powers to take Possession or make Sale.*

§ 1961. **In general — Time and Manner of Exercise of Powers.** — In the United States, the same objects which in England are attained by empowering debenture-holders to appoint a “receiver” are accomplished by authorizing the trustees to take possession of the property covered by the charge, and by giving to them a power of sale.⁴ Where there are two trustees both must concur in the exercise of any such powers.⁵ A power to enforce the security by taking possession of the property covered by the charge survives the dissolution of the corporation.⁶ The courts may direct the exercise of such a power under their supervision.⁷

§ 1962. **Rights and Liabilities of Trustees when in Possession in Exercise of Power.** — Where the trustees, in exercise of a power conferred upon them by the deed of trust, take possession of the property covered by the charge and continue the conduct of the business, their position is in many respects similar to that of an English “receiver” appointed by debenture-holders.⁸ Like

¹ *Maskelyne British Typewriter Lumber Co.*, 103 Mich. 392; 61 N. W. (1898), 1 Ch. 133. 668. Cf. *infra*, § 1978 et seq.

² Cf. *Joshua Stubbs, Ltd* (1891), 1 Ch. 475. ⁵ *Farmers’ L. & T. Co. v. Lake Street Elevated R. Co.*, 122 Fed. 914.

³ *Henry Pound, Son and Hutchins*, 42 Ch. D. 402. ⁶ *Nelson v. Hubbard*, 96 Ala. 238, 254; 11 So. 428; 17 L. R. A. 375.

⁴ In some cases an unfortunate disposition to look upon such powers with suspicion, and to construe them strictly, has been evinced. ⁷ *Nelson v. Hubbard*, 96 Ala. 238, 254; 11 So. 428; 17 L. R. A. 375. Cf. *Bradley v. Chester Valley R. R. Co.*, 36 Pa. St. 141.

Michigan Trust Co. v. Lansing ⁸ *Supra*, § 1960.

such a "receiver," they cannot, unless the covering deed of trust either expressly or by implication so provide, be deemed agents of the company.¹ On the contrary, they are personally liable on the contracts they enter into as trustees.² To be sure, they are entitled to reimbursement for their expenses out of the trust property;³ but they cannot be deemed agents of the bondholders,⁴ and therefore have no power to bind them personally.⁵ The trustees, are, moreover, liable *ex delicto* for all torts committed in the course of carrying on the business.⁶ So, they are subject to all statutory liabilities to which the corporation while carrying on its own business was subject.⁷ A trustee in possession under a power holds as trustee for the company as well as for the bondholders; and the company may file a bill for an account against him.⁸ He may not deal in the bonds for his own benefit, and cannot make a valid contract to lease the property to another corporation in which he is a shareholder and director.⁹

§ 1963. **Liabilities of the Company while the Trustees are in Possession.** — Since the trustees are not agents of the company, the company is not liable for the torts which they or their servants commit;¹⁰ but of course it is liable for any consequences

¹ *Chaffee v. Rutland R. R. Co.*, (Mass.) 47; *Sprague v. Smith*, 29 Vt. 345.

² *Chaffee v. Rutland R. R. Co.*, 53 Vt. 345 (semble); *Sprague v. Smith*, 29 Vt. 421; 70 Am. Dec. 424.

Cf. *Wilkinson v. Fleming*, 30 Ill. 353; *Rogers v. Wheeler*, 43 N. Y. 598. Of course, they are not liable on contracts made by the company before they took possession. *Wallbridge v. Farwell*, 18 Can. Sup. Ct. 1.

³ *Chaffee v. Rutland R. R. Co.*, 53 Vt. 345. Cf. *Queen Anne's Ferry, etc. Co. v. Queen Anne's R. R. Co.*, 148 Fed. 41 (expenses incurred by committee of bondholders in operating railway entitled to preference over the bonds).

⁴ But as to this compare *supra*, § 1960.

⁵ *Chaffee v. Rutland R. R. Co.*, 53 Vt. 345; *Stratton v. European, etc. Ry.*, 74 Me. 422 (semble).

⁶ *Ballou v. Farnum*, 9 Allen Co. v. *Ullman*, 89 Ill. 244.

(Mass.) 47; *Sprague v. Smith*, 29 Vt. 421; 70 Am. Dec. 424.

Cf. *Barter v. Wheeler*, 49 N. H. 9; 6 Am. Rep. 434; *Stratton v. European, etc. Ry.*, 74 Me. 422, 426-427; *Stratton v. European, etc. Ry. Co.*, 76 Me. 269; *Cooley v. Brainerd*, 38 Vt. 394; *Rogers v. Wheeler*, 43 N. Y. 598.

⁷ *Daniels v. Hart*, 118 Mass. 543; *Lamphear v. Buckingham*, 33 Conn. 237; *Farrell v. Union Trust Co.*, 77 Mo. 475; *Jones v. Seligman*, 81 N. Y. 190; *Rogers v. Wheeler*, 43 N. Y. 598.

But see *Stratton v. European, etc. Ry.*, 74 Me. 422; *Stratton v. European, etc. Ry.*, 76 Me. 269, in which cases the trustees' liability was limited by statute.

⁸ *Ashuelot R. R. Co. v. Elliot*, 57 N. H. 397.

⁹ *Ashuelot R. R. Co. v. Elliot*, 57 N. H. 397.

¹⁰ But see *Grand Tower Mfg., etc.*

of its own wrongful acts or breaches of duty committed before the trustees took possession,¹ and may, moreover, be liable for the acts and defaults of the trustees unless their possession is exclusive and notorious.² *A fortiori*, the company is not liable to indictment for any violations of statutory requirements which the trustees in carrying on the business may commit.³

§ 1964. **Powers of Sale.** — Powers of sale, when conferred at all, are, as stated above, usually given to the trustee; but they may be vested in a majority of the bondholders. A power to any bondholder to make sale, would, however, be void for indefiniteness.⁴ The deed of trust may authorize the trustees to purchase on behalf of the bondholders at their own sale.⁵ A power of sale vested in the trustees may be exercised although the trustees have previously entered on the property under a power to take possession: they are not put to an election as to which power they will exercise.⁶ Where a power of sale may be exercised only after sixty days' notice to the company and after sixty days' advertisement of the sale, the two periods are not synchronous but successive.⁷ A power to sell in case of default may be exercised without waiting to ascertain the amount of valid outstanding bonds;⁸ the trustee in exercise of the power, unlike a court in decreeing a foreclosure sale,⁹ is not bound to safeguard the company's right of redemption. A power to sell in case taxes are allowed to remain in arrear for a certain period may be exercised at any time after the default has continued for that length of time, even though the taxes may meanwhile have been paid.¹⁰

§ 1965-§ 1990. *ENFORCEMENT BY THE COURTS—
NATURE AND STRUCTURE OF THE PROCEEDING.*

§ 1965. **Right to resort to the Courts for Enforcement of the Security.** — The powers of holders of bonds or debentures or

¹ *Union Trust Co. v. Cuppy*, 26 Kans. 754, 769.

⁵ *Etna Coal, etc. Co. v. Marting Iron, etc. Co.*, 127 Fed. 32.

² *Pennsylvania R. R. Co. v. Jones*, 155 U. S. 333, 351-354; 15 Sup. Ct. 136.

⁶ *Macon, etc. R. R. Co. v. Georgia R. R. Co.*, 63 Ga. 103.

³ *State v. Consolidated Ry. Co.*, 67 Me. 479.

⁷ *Macon, etc. R. R. Co. v. Georgia R. R. Co.*, 63 Ga. 103.

⁴ *Mason v. York & Cumberland R. R. Co.*, 52 Me. 82, 103-104 (head-note inadequate).

⁸ *State v. Brown*, 64 Md. 199, 205; 1 Atl. 54; 6 Atl. 172.

⁹ *Infra*, § 2024.

¹⁰ *Union Trust Co. v. Thomas* (Md.), 66 Atl. 450.

of their trustees or so-called "receiver" to take possession of the property and realize upon the security without judicial assistance are comparatively seldom exercised. Some person in interest is very apt to take the matter into court; for it is well settled that powers given to the bondholders or their trustees to enforce the security by entering into possession or making sale are cumulative merely, and do not prevent a resort to the ordinary remedies in the courts.¹

§ 1966. **Suits instituted by the Trustee.**—The trustees of the mortgage, representing all the bondholders for purposes of litigation, are the natural and appropriate parties plaintiff in any bill for the enforcement of the security or, as it is generally called, for the foreclosure of the mortgage, without making the bondholders actual parties.² It is error to join a bondholder as co-

¹ *McAllister v. Plant*, 54 Miss. 106, 118-119; *Hall v. Sullivan R. R. Co.*, 1 Brunner Coll. Cas. 613; 11 Fed. Cas. 257; *Williamson v. New Albany, etc. R. R. Co.*, 1 Biss. 198; *Mendenhall v. West Chester, etc. R. R. Co.*, 36 Pa. St. 145 n., 150 n.; *McFadden v. Mays Landing, etc. Co.*, 49 N. J. Eq. 176; 22 Atl. 932; *Alexander v. Central R. R.*, 3 Dill. 487; *Allan v. Manitoba, etc. Ry. Co.*, 10 Manitoba 106; *Farmers' L. & T. Co. v. Nova Scotia, etc. Ry. Co.*, 24 Nova Scotia 542; *Eaton, etc. R. R. Co. v. Hunt*, 20 Ind. 457; *Dow v. Memphis, etc. R. R. Co.*, 20 Fed. 260; *Guardian Trust Co. v. White Cliffs, etc. Co.*, 109 Fed. 523; *Louisville, etc. R. R. Co. v. Schmidt*, 52 S. W. 835; 21 Ky. Law Rep. 556; *First Nat. Fire Ins. Co. v. Salisbury*, 130 Mass. 303, 309. In the last case the court said: "These provisions do not abridge the rights of the defendants as mortgagees, except in those particulars in which they are inconsistent with those rights. In the absence of any stipulation that a mortgagor may retain possession of the mortgaged property, a mortgagee has the right to take possession at any time; and so far as the mortgage of the defendants provides otherwise, it abridges

their rights as mortgagees. But the provision as to a sale of the property is in addition to the rights ordinarily in a mortgagee, and not inconsistent therewith, so that the rights of the defendants under this mortgage with reference to possession and management of the property, and for foreclosure of the mortgage after default in payment of interest has continued six months are precisely what they would have been if the provisions referred to had not been contained in the instrument." See also *infra*, § 1978-§ 1981.

But see *Rice v. St. Paul, etc. R. R. Co.*, 24 Minn. 464; *Union Trust Co. v. Thomas* (Md.), 66 Atl. 450 (where the court held that the sale should be made by the trustee named in the mortgage rather than by the receiver appointed by the court).

² *Hall v. Sullivan R. R. Co.*, 1 Brunner Coll. Cas. 613 (headnote inadequate); *Wright v. Bundy*, 11 Ind. 398; *Shaw v. Norfolk, etc. R. R. Co.*, 5 Gray (Mass.) 162; *Campbell v. Railroad Co.*, 1 Woods 368; *Grand Trunk Ry. Co. v. Central Vermont R. Co.*, 88 Fed. 622. Cf. *Bardstown, etc. R. R. Co. v. Metcalfe*, 4 Met. (Ky.) 199; 81 Am. Dec. 541;

plaintiff with the trustees.¹ If any bondholder is dissatisfied with the manner in which the trustees' suit is framed or conducted, he may be permitted to intervene and be made a party defendant, although not a party plaintiff.² A bondholder will not be allowed to intervene prior to the foreclosure sale for the purpose of asserting an alleged preference over the other bondholders;³ for that question should properly be raised when the proceeds of sale come to be distributed. Nor should a bondholder be allowed to intervene in order to set up by cross bill any substantially independent cause of action, such as a claim against the trustee for misconduct.⁴

Willink v. Morris Canal, etc. Co., 4 N. J. Eq. 377.

But see *Brooks v. Vermont Central R. R. Co.*, 14 Blatchf. 463, 466.

As to whether one of several trustees may sue alone, see *Robinson v. Alabama, etc. Mfg. Co.*, 48 Fed. 12.

¹ *Consolidated Water Co. v. City of San Diego*, 92 Fed. 759.

² *Williamson v. New Jersey Southern R. R. Co.*, 25 N. J. Eq. 13; *Farmers' L. & T. Co. v. Cape Fear, etc. Ry. Co.*, 71 Fed. 38; *Central Trust Co. v. Washington County R. R. Co.*, 124 Fed. 813; *Grand Trunk Ry. Co. v. Central Vt. R. Co.*, 88 Fed. 622 (where the same corporation was trustee under a first and under a second mortgage and where a question arose as to the relative priorities of the two charges). Cf. *Tillinghast v. Troy, etc. R. R. Co.*, 48 Hun (N. Y.) 420; 1 N. Y. Supp. 243; *Campbell v. Railroad Co.*, 1 Woods 368; *De Betz's Petition*, 9 Abb. N. C. (N. Y.) 246; *Farmers' L. & T. Co. v. Northern Pac. R. R. Co.*, 70 Fed. 423 (where the plaintiff was trustee for several series of bonds); *Toler v. East Tennessee, etc. Ry. Co.*, 67 Fed. 168 (intervention for purpose of resisting prosecution of suit); *Farmers' L. & T. Co. v. Northern Pac. R. R. Co.*, 66 Fed. 169 (plaintiff trustee for several sets of bonds,

and bondholders allowed to intervene notwithstanding provision in mortgage that no bondholder should be allowed to sue except after refusal of trustee to sue on request); *Parsons v. Little*, 28 App. D. C. 218.

But see *Winslow v. Minnesota, etc. R. R. Co.*, 4 Minn. 313 (headnote inadequate); 77 Am. Dec. 519; *Clyde v. Richmond, etc. R. R. Co.*, 55 Fed. 445; *Bowling Green Trust Co. v. Virginia Passenger, etc. Co.*, 132 Fed. 921; *Central Trust Co. v. Unadilla Valley Ry. Co.*, 72 N. Y. Supp. 189; 35 N. Y. Misc. 604. Cf. *Mercantile Trust Co. v. Baltimore, etc. R. R. Co.*, 94 Fed. 722 (where individual bondholders were allowed to sue to compel payment of interest on the bonds by a lessee of the obligor company who had agreed to pay such interest as part of the rental).

As to the right of a general creditor to intervene, see *Savings, etc. Trust Co. v. Bear Valley Irr. Co.*, 93 Fed. 339; *Hindman v. Great Western Coal, etc. Co.* (Wash.), 92 Pac. 139.

³ *Mercantile Trust Co. v. United States Shipbuilding Co.*, 130 Fed. 725. Cf. *Central Trust Co. v. Unadilla Valley Ry. Co.*, 72 N. Y. Supp. 189; 35 N. Y. Misc. 604.

⁴ *Thruston v. Big Stone Gap Imp. Co.*, 86 Fed. 484.

§ 1967-§ 1977. SUITS INSTITUTED BY BONDHOLDERS.

§ 1967-§ 1970. *When Bondholders may sue.*

§ 1967. **In general.** — Without showing some reason why the bill is not filed in the name of the trustees, a bondholder cannot bring suit to enforce the security.¹ But if the trustees refuse to institute proceedings in a proper case, any bondholder (unless restrained by the terms of the bonds or deed of trust) may file the bill, making the trustees defendants;² and it has been held that the same course may be pursued where the trustee has adverse interests, so that he could not maintain the bondholders' rights without attacking his own,³ or where the trustee has been guilty

¹ *Morgan v. Kansas Pac. Ry. Co.* 15 Fed. 55; *Virginia Pass., etc. Co. v. Fisher* (Va.), 51 S. E. 198; 104 Va. 121; *General Electric Co. v. La Grand, etc. Co.*, 87 Fed. 590; 31 C. C. A. 118, affirming 79 Fed. 25. Cf. *D. A. Tompkins Co. v. Catawba Mills*, 82 Fed. 780.

² *Hotel Co. v. Wade*, 97 U. S. 13; *First Nat. Fire Ins. Co. v. Salisbury*, 130 Mass. 303; *Alexander v. Central R. R. Co.*, 3 Dill. 487; *Schultze v. Van Doren* (N. J.), 53 Atl. 815; 64 N. J. Eq. 465, affirmed without opinion, 55 Atl. 1133; 65 N. J. Eq. 764; *Louisville, etc. R. R. Co. v. Schmidt*, 52 S. W. 835; 21 Ky. Law Rep. 556. Cf. *Mason v. York & Cumberland R. R. Co.*, 52 Me. 82; *Stevens v. Union Trust Co.*, 57 Hun 498; 11 N. Y. Supp. 268; *Weetjen v. Vibbard*, 5 Hun 265.

But see *Stevens v. Eldridge*, 4 Cliff. 348.

As to a vacancy in the office of trustee, see *Wheelwright v. St. Louis, etc. Co.*, 56 Fed. 164.

As to death of trustee, see *Gibert v. Washington, etc. R. R. Co.*, 33 Gratt. (Va.) 586, 614-615; *Inhabitants of Anson*, 85 Me. 79, 88; 26 Atl. 996 (semble); *Shaw v. Norfolk, etc. R. R. Co.*, 5 Gray (Mass.) 162; *Lambertville Nat. Bank*

v. McCreedy, etc. Co., 15 Atl. Rep. 388 (N. J.).

As to insolvency of a corporation trustee, see *Clay v. Selah Valley, etc. Co.*, 14 Wash. 543 (headnote inadequate); 45 Pac. 141.

As to what amounts to a refusal by the trustee to institute proceedings and as to what conditions he has a right to exact of the requesting bondholder, see *Beebe v. Richmond Power Co.*, 13 N. Y. Misc. 737; 35 N. Y. Supp. 1.

As to the necessity for making the trustee a party, see *Hale v. Nashua, etc. R. R. Co.*, 60 N. H. 333; *Mercantile Trust Co. v. Portland, etc. R. R. Co.*, 10 Fed. 604; *Morgan v. Kansas Pac. Ry. Co.*, 15 Fed. 55. But see *Spies v. Chicago, etc. R. Co.*, 30 Fed. 397; *Stewart v. Chesapeake, etc. Canal Co.*, 1 Fed. 361.

As to whether the trustee should be deemed a plaintiff or defendant for purposes of determining whether the federal courts have jurisdiction of the controversy, see *First Nat. Bank v. Radford Trust Co.*, 80 Fed. 569; 26 C. C. A. 1, and cases cited.

³ *Webb v. Vermont Central R. R. Co.*, 20 Blatchf. 218; 9 Fed. 793; *Clay v. Selah Valley, etc. Co.*, 14 Wash. 543 (headnote inadequate);

of fraud,¹ or where the trustee has left the country and is insane.² In such a suit by bondholders, they are entitled to any relief which the trustee, had he been plaintiff, might have obtained, such as specific performance of covenants for further assurance, etc.³ An injunction granted by a state court restraining the trustee from suing for foreclosure does not prevent a suit by bondholders in the federal courts with that object.⁴ If the trustees are permitted by amendment to be made plaintiffs instead of defendants in a bondholder's suit,⁵ they instead of the plaintiff bondholder thenceforward control the litigation.⁶ The fact that the trustees have filed a bill for the enforcement of the security ordinarily precludes any independent suit by a bondholder with a similar object, at any rate in the same court, even though the form of relief prayed by the trustees may be unsatisfactory and although the trustees may be accused of fraud.⁷ The proper remedy of the bondholder in such a case is by intervention in the trustees' suit.⁸

Bondholders who refuse to join the complaining bondholder as plaintiffs may be made defendants, but this is not necessary, especially when those bondholders are non-residents.⁹

§ 1968. **Effect of Pendency of Suit by other Bondholders.** — On principle, it would seem that after one suit has been instituted by one bondholder on behalf of all for the purpose of enforcing the security, no other bondholder should be at liberty to institute another suit in courts of the same state;¹⁰ but the pendency of a

45 Pac. 141; *Cochran v. Pittsburg, etc. R. Co.*, 150 Fed. 682.

Cf. *Mercantile Trust Co. v. Lamoille Valley R. R. Co.*, 16 Blatchf. 324; *Farmers' L. & T. Co. v. Northern Pac. R. R. Co.*, 70 Fed. 423 (disapproving *Clyde v. Richmond, etc. R. R. Co.*, 55 Fed. 445); *Farmers' L. & T. Co. v. Northern Pac. R. R. Co.*, 66 Fed. 169; *Robinson v. Alabama Mfg. Co.*, 48 Fed. 12; *Bowling Green Trust Co. v. Virginia Passenger, etc. Co.*, 132 Fed. 921.

¹ *Clay v. Selah Valley, etc. Co.*, 14 Wash. 543, 549; 45 Pac. 141.

² *Ettlinger v. Persian Rug, etc. Co.*, 142 N. Y. 189; 36 N. E. 1055; 40 Am. St. Rep. 587.

³ *O'Beirne v. Allegheny, etc. R. R. Co.*, 151 N. Y. 372; 45 N. E. 873.

⁴ *Woodbury v. Allegheny, etc. Ry. Co.*, 72 Fed. 371.

⁵ As to this compare *Benson v. San Diego*, 100 Fed. 158.

⁶ *Richards v. Chesapeake, etc. R. R. Co.*, 1 Hughes 28. Cf. *Bird v. People's, etc. Co.*, 158 Fed. 963.

⁷ *Stern v. Wisconsin Central R. R. Co.*, 1 Fed. 555. Cf. *Beckman v. Hudson River, etc. Ry. Co.*, 35 Fed. 3.

⁸ *Supra*, § 1966.

⁹ *Hotel Co. v. Wade*, 97 U. S.

13.
¹⁰ Cf. *Alpha Co.* (1903), 1 Ch. 203, 207 (semble).

suit by one bondholder in a state court is no obstacle to a suit by another bondholder in a federal court, or in the courts of another state.¹

§ 1969. **Effect of Decree in Suit by other Bondholders.** — At all events, where a suit of one or more bondholders on behalf of all is prosecuted to judgment or decree, the judgment or decree will be conclusive and a bar to any subsequent suit by other bondholders, unless it was obtained by the fraud of the bondholder who assumed the representative position.²

§ 1970. **Procedure where mortgaged Property is in Possession of a Receiver.** — Where the property covered by the charge is in the possession of a receiver appointed in a suit on behalf of junior mortgagees, to which the first-mortgage bondholders are not parties, either actually or by representation by their trustee, they cannot disturb the possession of the receiver by filing an independent bill for the enforcement of their security, but should intervene in the other suit.³

§ 1971. **Allegation and Proof of Ownership of Bonds by Plaintiff.** — The mere possession of bonds or coupons is sufficient *prima facie* at least to entitle the possessor to maintain a suit as bondholder to enforce the rights of the bondholders.⁴ The fact that a bondholder has hypothecated his bonds to another person does not deprive him of his right of suing as a bondholder.⁵ But mere manual possession is not conclusive of a right to sue as a bondholder.⁶ If bonds are owned by several persons jointly, it seems

¹ *Brooks v. Vermont Central Ry. Co.*, 14 Blatchf. 463. Cf. *Beekman v. Hudson River, etc. Ry. Co.*, 35 Fed. 3, where the suit in the state court was brought by the trustee.

² *Stevens v. Union Trust Co.*, 57 Hun 498; 11 N. Y. Supp. 268.

But see *Eaton, etc. R. R. Co. v. Hunt*, 20 Ind. 457; and *infra*, § 1975.

³ *Young v. Montgomery, etc. R. R. Co.*, 2 Woods 606.

⁴ *Butler v. Rahm*, 46 Md. 541, 550.

But see *Messchaert v. Kennedy*, 4 McCrary 133, 134; 13 Fed. 242. As to possession of bearer bonds as evidence of ownership, see also *supra*, § 1763.

⁵ *Butler v. Rahm*, 46 Md. 541, 550.

⁶ *Sahlguard v. Kennedy*, 13 Fed. 242, 247 (headnote inadequate). Cf. *Nashua Savings Bank v. Burlington Electric Light Co.*, 99 Fed. 14

that all must be made parties.¹ An averment that coupons maturing at a certain time are "due and wholly unpaid, together with interest thereon, to your orator and other holders of said bonds," is a sufficient allegation of ownership by the complainant.² It is not necessary that the bonds or coupons should be produced before a decree of foreclosure *nisi*; proof of a default and the amount thereof is sufficient.³

§ 1972-§ 1975. *Complainant as Representative of all the Bondholders.*

§ 1972. **In general — Whether Plaintiff should sue on behalf of all the Bondholders.** — The plaintiff in a bondholder's suit should ordinarily sue on behalf of all the bondholders, and should see that the decree is for the equal benefit of all;⁴ but an allegation that the suit is brought on behalf of all the bondholders is unnecessary when default has been committed only in respect to the bonds held by the plaintiff.⁵

§ 1973. **Effect of Diversity of Interests among the Persons on behalf of whom Plaintiff attempts to sue.** — Where the plaintiff is the holder of both first and second mortgage bonds, he may sue on behalf of both classes of bondholders notwithstanding the possible conflict between their interests;⁶ their interests are no more conflicting than those of the several holders of bonds or debentures of the same series, since it is always to the advantage of each bondholder to have as few prior claims to his and as few participants with him as possible. On the other hand, where the mortgage is not made to trustees according to the usual American custom, nor to each several holder according to a not uncommon English custom,⁷ but to the fourteen or fifteen origi-

(where the court directed an action at law to be brought to test the complainant's title, the company claiming that complainant had procured the bonds from it by fraud).

¹ *Messchaert v. Kennedy*, 4 McCrary 133; *Sahlgard v. Kennedy*, 13 Fed. 242.

² *Toler v. East Tenn., etc. Ry. Co.*, 67 Fed. 168.

³ *Toler v. East Tenn., etc. Ry. Co.*, 67 Fed. 168. Cf. *infra*, § 2024.

⁴ *New Orleans Pac. Ry. Co. v. Parker*, 143 U. S. 42, 58-60; 12 Sup. Ct. 364. Cf. *supra*, § 1892.

⁵ *McFadden v. Mays Landing, etc. Co.*, 49 N. J. Eq. 176; 22 Atl. 932.

⁶ *Galveston Railroad v. Cowdrey*, 11 Wall. 459, 478-479.

⁷ See also *King v. Tuscumbia R. R. Co.*, 7 Pa. L. J. 166.

nal bondholders jointly, all must unite in any bill to enforce the charge, especially when the security is insufficient, so that each bondholder has a lively interest to reduce the number of participants with him; and consequently in such a case a bill in the name of a single bondholder, although on behalf of all, must be dismissed.¹

§ 1974. **Description of the Persons on whose behalf Plaintiff sues.** — The class of persons on behalf of whom the plaintiff sues should be defined with reasonable accuracy. For this reason, where the plaintiff is described as suing "on behalf of himself and others the holders of the debentures of the defendant company and its predecessors in title," the description is too vague and requires amendment.²

§ 1975. **Fiduciary Position of the Plaintiff.** — Where one bondholder sues on behalf of all, he assumes the position of a quasi trustee towards the other bondholders. As stated above, his duty is to see that all the proceedings are conducted for the common benefit of all, and not for his individual advantage,³ and if he neglect this duty, the decree will be set aside.⁴ But inasmuch as the plaintiff's fiduciary position is self-assumed, he has none of the powers such as a trustee might have to bind the other bondholders by contracts, agreements, or assents to orders of court of a kind that could not be passed without unanimous consent.⁵ Moreover, even after the passage of orders appointing a receiver and directing an account of the outstanding debentures and an inquiry as to the property subject to the charge and as to other encumbrancers and their priorities, the plaintiff debenture-holder may dismiss the suit where he has no notice of any claim and is not required to go on by any other debenture-holder.⁶ Indeed, it has even been held that a decree adverse to the complain-

¹ *Railroad Company v. Orr*, 18 Wall. 471. Some of the dicta in this case (which was not argued on behalf of the plaintiff) seem contrary to *Galveston R. R. Co. v. Cowdrey*, ubi supra, which was not cited by the court. Cf. *Wheelwright v. St. Louis, etc. Co.*, 56 Fed. 164.

² *Marshall v. South Staffordshire Tramways Co.* (1895), 2 Ch. 36, 40-41.

³ *New Orleans Pac. Ry. Co. v. Parker*, 143 U. S. 42, 58-59; 12 Sup. Ct. 364.

⁴ *Jackson v. Ludeling*, 21 Wall. 616; *Stevens v. Union Trust Co.*, 57 Hun (N. Y.) 498; 11 N. Y. Supp. 268.

⁵ *Securities, etc. Corp. v. Brighton Alhambra*, 62 L. J. Ch. 566; 68 L. T. 249.

⁶ *Alpha Co.* (1903), 1 Ch. 203.

ant and decreeing that he has no lien will not bind other bondholders.¹

§ 1976. **Counsel Fees and Costs.** — In England, if the fund realized by the suit is insufficient to pay in full all the bonds on behalf of whose holders the plaintiff sues, the plaintiff is entitled out of the general fund to his costs not merely as between party and party but also as between solicitor and client;² but if the fund is more than sufficient, he is not entitled to his costs as between solicitor and client.³ In the United States, this distinction has not heretofore been taken, the plaintiff bondholder being allowed as a matter of course his reasonable counsel-fees.⁴ Of course, the plaintiff is entitled to his costs as between party and party except such, if any, as were incurred in protecting or attempting to protect his own individual interests.⁵ If the amount realized by the suit be insufficient to pay all the costs as between party and party, it would seem that in the ordinary case the plaintiff should not be liable for the deficiency.⁶

As the trustees of bondholders or debenture-holders are necessary parties defendant to the suit, their solicitor's fees, as well as costs between party and party, are according to the English rule allowed out of the fund;⁷ but in a case in a federal court such an allowance was denied.⁸

¹ *Wabash R. R. Co. v. Adelbert College*, 208 U. S. 38; 28 Sup. Ct. 182. Note that in this case the bonds were not secured by a formal deed of trust. In ordinary cases, as the trustee must be made a party defendant the other bondholders would be bound by any decree that might be passed, if not on account of the representative character of the plaintiff, then by the representation of the trustee. As to whether all the bondholders are bound by the complainant's representation, see *supra*, § 1969, and *infra*, § 2050.

² *New Zealand Midland Ry. Co.* (1901), 2 Ch. 357.

³ *Queen's Hotel Co.* (1900), 1 Ch. 792. Cf. *W. C. Horne & Sons* (1906), 1 Ch. 271.

⁴ Cf. *Morton v. New Orleans, etc. Ry. Co.*, 79 Ala. 590; *Hand v. Savannah, etc. R. R. Co.*, 21 S. Car. 162.

⁵ *Carrick v. Wigan Tramways Co.*, W. N. (1893) 98.

⁶ See *infra*, § 2042.

⁷ *Mortgage Ins. Corp. v. Canadian Agricultural, etc. Co.* (1901), 2 Ch. 377.

⁸ *Investment Co. v. Ohio, etc. R. R. Co.*, 46 Fed. 696.

§ 1977. **Intervention by other Bondholders.** — If any of the bondholders are discontented with the manner in which the suit is conducted by the party who filed the bill nominally on their behalf, they are entitled as of right, upon first obtaining the formal permission of the court, to become parties to the cause by intervention and to set up their views of the case:¹ they need not allege fraud on the part of the plaintiff, for it is ordinarily a sufficient reason that they prefer to conduct their own case.² The fact that one bondholder or debenture-holder has exercised this right does not prevent others from taking the same course if they think that neither the plaintiff nor the first intervenor is adequately representing their case.³ If, however, the case is allowed to proceed to decree, and a decree entered in accordance with the wishes of the plaintiff, no other bondholder can appeal therefrom;⁴ for the decree stands in favor of his representative. Sometimes other bondholders may intervene for the purpose of resisting instead of furthering the foreclosure and sale sought by the plaintiff bondholders.⁵

§ 1978—§ 1982. *Provisions in the Bonds or Deed of Trust regulating Institution and Conduct of Proceedings for Enforcement of the Security.*

§ 1978. **In general — Strict Construction.** — Restrictive provisions are often found in corporation bonds and deeds of trust purporting to regulate the institution and conduct of proceedings for enforcement of the security. The validity and effect of such regulations are matters upon which the authorities are not altogether clear. In the first place, any clause in a mortgage limiting the right of the mortgagee to enforce the security by

¹ In addition to cases cited *infra*, see *Williams v. Morgan*, 111 U. S. 684; 4 Sup. Ct. 638; *Galveston Railroad v. Cowdrey*, 11 Wall. 459, 478 (semble); *New Orleans Ry. Co. v. Parker*, 143 U. S. 42, 58–59; 12 Sup. Ct. 364 (semble); *Re Chickering*, 56 Vt. 82; *Toler v. East Tennessee, etc. Ry. Co.*, 67 Fed. 168.

But see *Skiddy v. Atlantic, etc. R. R. Co.*, 3 Hughes 320.

As to a case where the admission

of an intervenor as plaintiff would oust the jurisdiction of the court, see *Jackson, etc. Co. v. Burlington, etc. R. Co.*, 29 Fed. 474.

² *Debenture Corp. v. Murietta*, 8 Times L. R. 496.

³ *Fraser v. Cooper*, 21 Ch. D. 718.

⁴ *Watson v. Cave (No. 1)*, 17 Ch. D. 19.

⁵ Cf. *Toler v. East Tenn., etc. Ry. Co.*, 67 Fed. 168.

legal proceedings may well enough be strictly construed.¹ Hence, a clause restricting the power of sale vested in the trustee to cases in which a majority of the bondholders request the sale, or until the default has continued for some specified period, will have no application to the institution of judicial proceedings looking to a sale² even though a further clause attempts to make the mode of sale provided in the mortgage exclusive of all others.³ For the same reason other restrictions on the exercise of a power of sale have no application to a judicial or foreclosure sale.⁴ So, a provision that the principal shall become due upon four months' default in payment of interest and that the trustee shall thereupon, upon the written request of holders of a majority of the outstanding bonds, proceed to foreclose the mortgage, has been held not to restrict the right to institute foreclosure proceedings for default in interest to cases where such written request has been made, unless advantage is sought to be taken of the clause accelerating the maturity of the principal.⁵ Again, a provision that the mortgagor company shall be entitled to possession until six months after written demand of payment by the trustee does not prevent the trustee from filing a bill for foreclosure immediately upon default without making demand and without waiting for six months.⁶

For similar reasons, it is clear that a clause authorizing trustees to refuse to institute proceedings for the enforcement of the security until properly indemnified merely confers a privilege upon the trustees and does not restrict their right, if they be so

¹ *Guaranty Trust, etc. Co. v. Green Cove, etc. R. R. Co.*, 139 U. S. 137; 11 Sup. Ct. 512; *Toler v. East Tenn., etc. Ry. Co.*, 67 Fed. 168. ⁴ *Robinson v. Alabama, etc. Mfg. Co.*, 48 Fed. 12. Cf. *Guardian Trust Co. v. White Cliffs, etc. Co.*, 109 Fed. 523.

² *Guaranty Trust, etc. Co. v. Green Cove, etc. R. R. Co.*, 139 U. S. 137; 11 Sup. Ct. 512; *Mercantile Trust Co. v. Missouri, etc. Ry. Co.*, 36 Fed. 221; *Robinson v. Alabama, etc. Mfg. Co.*, 48 Fed. 12; *Reinhardt v. Interstate Tel. Co. (N. J.)*, 63 Atl. 1097, 1100 (headnote inadequate). Cf. *Morgan's, etc. Co. v. Texas Central Ry. Co.*, 137 U. S. 171; 11 Sup. Ct. 61. ⁵ *Beekman v. Hudson River, etc. Ry. Co.*, 35 Fed. 3, 10-11. Cf. *Farmers' L. & T. Co. v. Chicago, etc. Ry. Co.*, 27 Fed. 146; *Toler v. East Tenn., etc. Ry. Co.*, 67 Fed. 168; *Central Trust Co. v. Texas, etc. Ry. Co.*, 23 Fed. 846.

⁶ *Farmers' L. & T. Co. v. Winona, etc. Ry. Co.*, 59 Fed. 957; *Mercantile Trust Co. v. Chicago, etc. Ry. Co.*, 61 Fed. 372; *Mercantile Trust Co. v. Missouri, etc. Ry. Co.*, 36 Fed. 221. Cf. *Guardian Trust Co. v. White Cliffs, etc. Co.*, 109 Fed. 523.

minded, to begin foreclosure proceedings without insisting on indemnity.¹

Provisions restricting the right to enforce the security have no application to a bill by a bondholder, under a statute, as a creditor of the company to effect its dissolution and winding-up.²

Moreover, in any case of fraud a court of equity would always make short work of any restrictions on the right to invoke its remedial powers.³

§ 1979. **Waiver by Company of Restrictions on Power to Institute Foreclosure Proceedings.** — Moreover, a provision in a deed of trust to secure an issue of bonds whereby foreclosure suits are restricted has been held to give a mere personal privilege to the company, so that the objection to a suit on behalf of the bondholders to enforce their security cannot be raised by third persons, such as intervening general creditors or trustees in insolvency.⁴

§ 1980. **Validity of Restrictive Regulations.** — On the other hand, except in case of fraud, the true intent and meaning of such restrictive regulations when clearly ascertained should not be defeated upon the pretext that the clause ousts the jurisdiction of the courts and is therefore contrary to public policy.⁵ In the main, the authorities support this proposition, at least where the provision in question is merely a reasonable restriction upon the right to resort to the courts. Thus, in England a provision that no debenture-holder should commence any proceeding to enforce the security, to procure the appointment of a receiver, or to obtain a sale, unless written notice should first be served on the trustees of the covering deed calling upon them to act, and unless for six months after such notice they should neglect or refuse to take the necessary steps, was not merely enforced, but was even very liberally construed.⁶ So, a provision that where the principal of the bonds should have been declared to

¹ *Phillips v. Southern Division, etc. R. R. Co.* (Ky.), 60 S. W. 941; 22 Ky. Law. Rep. 1530.

² *Reinhardt v. Interstate Tel. Co.* (N. J.), 63 Atl. 1097.

³ Cf. *Clay v. Selah Valley, etc. Co.*, 14 Wash. 543; 45 Pac. 141; *Cochran v. Pittsburg, etc. R. Co.*, 150 Fed. 682.

⁴ *Central Trust Co. v. Worcester Cycle Mfg. Co.*, 93 Fed. 712; 35 C. C. A. 547.

⁵ Cf. *First Nat. Fire Ins. Co. v. Salisbury*, 130 Mass. 303.

⁶ *Rogers & Co. v. British & Colonial Ass'n*, 68 L. J. Q. B. 14.

be due on account of a default in payment of interest, the majority of the bondholders should have the right to direct the trustees to proceed to collect principal and interest, by foreclosure and sale, or otherwise, was construed by the Federal Supreme Court as impliedly prohibiting any bill for foreclosure except upon the direction of a majority of the bondholders; and so construed, the provision was enforced.¹ Moreover, an express provision that no bill to foreclose should be maintainable except by the trustee and upon the written request of a certain proportion of the bondholders has been pronounced by a federal judge to be valid and enforceable,² although such a provision would not apply where the trustee is interested adversely to the bondholders.³ Therefore, where the trustee by the terms of the covering deed of trust, upon the request of the holders of a certain amount of bonds, is required to file a bill for foreclosure and sale, and is authorized to do so in his discretion without such request, a bill filed by the trustee supposedly upon the request of the requisite number of bondholders cannot be maintained if the requesters did not in fact own the bonds on which their request was based;⁴ for, the contemplation of the parties was that unless a request was made by a sufficient number of bondholders, the trustee should exercise his independent discretion before commencement of the suit. So too, a provision that the company may continue in possession until a default in payment of interest shall have continued for six months and that no suit for foreclosure shall be instituted except as provided in the deed of trust has been thought to be a defence to a suit for foreclosure instituted before default in interest payments has continued for six months.⁵

¹ *Chicago, etc. R. R. Co. v. Fostick*, 106 U. S. 47, 76-78; 1 Sup. Ct. St. Rep. 689; 34 L. R. A. 76 (semble).
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² *M'George v. Big Stone Gap Imp. Co.*, 57 Fed. 262. Cf. *Farmers' L. & T. Co. v. Northern Pac. R. R. Co.*, 66 Fed. 169. But cf. *Farmers' L. & T. Co. v. New York, etc. Ry. Co.*, 94 N. Y. Supp. 928; *Knickerbocker Trust Co. v. Oneonta, etc. Ry. Co.*, 101 N. Y. Supp. 241.

But see *Linder v. Hartwell R. R. Co.*, 73 Fed. 320 (a case of fraud). These cases also bear upon the question who are to be deemed the

³ *Cochran v. Pittsburg, etc. R. Co.*, 150 Fed. 682. "holders of bonds" within the meaning of such provisions.

⁴ *Farmers' L. & T. Co. v. New York, etc. Ry. Co.*, 150 N. Y. 410, 436-438; 44 N. E. 1043; 55 Am. ⁵ *Central Trust Co. v. Worcester Cycle Mfg. Co.*, 93 Fed. 712 (head-note misleading); 35 C. C. A. 547.

§ 1981. **Invalidity of absolute Prohibitions of Judicial Proceedings to enforce the Security.** — On the other hand, any attempt to take away altogether the remedy by resort to the courts will be nugatory. Thus, a stipulation that no part of the property covered by the charge shall be sold under proceedings at law or in equity, but that the mode of sale under the power contained in the mortgage shall be exclusive, has been declared to be void, as ousting the courts of their jurisdiction.¹ It is submitted that this doctrine should be confined to attempts wholly to cut off resort to the courts, so as to have no application to mere regulations as to the mode in which judicial intervention may be invoked or as to the manner in which it may be exercised.²

§ 1982. **Suits instituted fraudulently — Effect of Plaintiff's Motives.** — Where the bill is filed fraudulently, or where the default on which it was based was brought about by the fraudulent machinations of the bondholders, a court of equity will not entertain the suit. Thus, where a rival corporation, owning a majority of the capital stock and of the bonds of another company, in pursuance of a scheme to purchase its undertaking at a foreclosure sale, deliberately mismanages the business of the subordinate company so as to cause a default in payment of the bonded indebtedness, the court will not entertain a foreclosure suit.³ If the misconducting corporation had owned *all* of the bonds of the other company, the soundness of this decision could not for a moment be doubted: as the case stood, one is tempted to ask whether adequate protection was given to the other bondholders, who had been guilty of no fraud. At all events, the general rule is that the motives of the plaintiff in filing a bill to enforce the security of bondholders are immaterial.⁴

¹ *Guaranty Trust, etc. Co. v. Green Cove R. R. Co.*, 139 U. S. 137; 11 Sup. Ct. 512; *Reinhardt v. Interstate Tel. Co.* (N. J.), 63 Atl. 1097. Cf. *Krotz v. Louisiana Const. Co.* (La.), 45 So. 276, 278 (headnote inadequate). ³ *Farmers' L. & T. Co. v. New York, etc. Ry. Co.*, 150 N. Y. 410; 44 N. E. 1043; 55 Am. St. Rep. 689; 34 L. R. A. 76. Cf. *Tillinghast v. Troy, etc. R. R. Co.*, 48 Hun 420; 1 N. Y. Supp. 243.

² But see *Pennsylvania Co. v. Philadelph. etc. R. R. Co.*, 36 Wkly. Notes Cas. (Pa.) 534. ⁴ *Guardian Trust Co. v. White Cliffs, etc. Co.*, 109 Fed. 523.

§ 1983-§ 1989. DISTINCTION BETWEEN FORECLOSURE SUITS,
OR SUITS TO REALIZE ON THE BONDHOLDERS' SECURITY
AND OTHER CLASSES OF LEGAL PROCEEDINGS.

§ 1983-§ 1986. *Winding-up or Liquidation Proceedings
distinguished.*

§ 1983. **Reasons for Confusion of Winding-up Proceedings with Foreclosure Suits.** — Before considering in detail the proceedings which take place upon the usual bill to enforce the security of bondholders or debenture-holders — the relief that is granted and when and how it is granted — a few words upon the real nature of such an action or suit should be interjected. Inasmuch as the mortgage or charge usually covers practically all of the company's property, the result of the suit leaves the corporation stripped of its property, the mere shadow of a name. Hence, the proceeding is apt to be confused with a suit for the dissolution or winding-up of the company. The confusion is facilitated by the fact that in America courts of equity commonly have jurisdiction of both classes of proceedings; and a winding-up suit or action, apart from the circumstance that the jurisdiction of some statute or winding-up act must be invoked, does not differ in its general frame from any other suit in equity. It is begun by original bill, and the winding-up is effected through the instrumentality of an officer called a receiver, whose familiar chancery title serves to disguise his real functions as a statutory liquidator.

§ 1984. **The Distinction in general.** — In reality, however, the two classes of suits are in nature wholly distinct. For a bill by or on behalf of bondholders to enforce their security rests upon an old established head of equity jurisdiction and does not differ in kind from an ordinary bill for the foreclosure of a mortgage of a farm or messuage. The fact that the mortgage covers all the property of the corporation is a mere incident, which, to be sure, necessitates the preservation of the business as a going concern and calls into activity some extraordinary chancery powers, and which therefore lends some unusual features to the proceeding, without, however, changing its essential nature.¹

¹ *Decker v. Gardner*, 124 N. Y. 334; 26 N. E. 814; 11 L. R. A. 480. But see *Rogersville, etc. R. R. Co. v. Kyle*, 9 Lea (Tenn.) 691.

On the other hand, the jurisdiction to entertain a suit for the dissolution and winding-up of a corporation is wholly statutory.¹

§ 1985. **In the English Practice.** — This distinction between a suit to realize on the security of bonds or debentures and a winding-up proceeding is very clearly brought out in England, where the nature of a winding-up or liquidation as a special statutory proceeding is emphasized rather than obscured. The distinction between the two sorts of proceedings is carefully preserved. Thus, a petition for the winding-up of a company may be filed, as a separate proceeding, after a receiver has been appointed in a suit to enforce the debenture-holders' security.² Conversely, even after the commencement of winding-up proceedings, the debenture-holders may file a bill for a receiver for the enforcement of their charge,³ although if the winding-up is compulsory, they must first obtain the permission of the court in which the liquidation proceedings are being conducted, which permission, however, will ordinarily be granted as a matter of course.⁴ For reasons of convenience, the court will in such a case appoint to be receiver for the debenture-holders the same person who has previously been named as statutory liquidator;⁵ and for like reasons, where a receiver is appointed in a debenture-holders' action and subsequently a liquidator is appointed in winding-up proceedings, the court may in its discretion discharge the former receiver and appoint the person named as liquidator to be receiver in his room,⁶ but it is not bound to do so;⁷ and in

¹ *Conklin v. U. S. Shipbuilding Co.*, 140 Fed. 219.

² *Portsmouth Tramways Co.* (1892), 2 Ch. 362.

Cf. *St. Louis Car Co. v. Stillwater Street Ry. Co.*, 53 Minn. 129; 54 N. W. 1064.

³ *Wallace v. Universal Automatic, etc. Co.* (1894), 2 Ch. 547; *Victoria Steamboats* (1897), 1 Ch. 158; *Longdendale, etc. Co.*, 8 Ch. D. 150.

Cf. *Allan v. Manitoba, etc. Ry. Co.*, 10 Manitoba 106; *Herring v. New York, etc. R. R. Co.*, 105 N. Y. 340; 12 N. E. 763; *Pennsylvania Co. v. Jacksonville, etc. Ry. Co.*, 55 Fed. 131; 5 C. C. A. 53.

⁴ *David Lloyd & Co.*, 6 Ch. D. 339.

⁵ *Perry v. Oriental Hotels*, 5 Ch. 420; *Campbell v. Compagnie de Bellegarde*, 2 Ch. D. 181.

Cf. *St. Louis Car Co. v. Stillwater Street Ry. Co.*, 53 Minn. 129; 54 N. W. 1064; *Wabash, etc. Ry. Co. v. Central Trust Co.*, 22 Fed. 272.

⁶ *Tottenham v. Swansea Zinc Ore Co.*, 53 L. J. Ch. 776; *Bartlett v. Northumberland Ave. Co.*, 53 L. T. 611.

⁷ *Joshua Stubbs, Ltd.* (1891), 1 Ch. 475; *British Linen Co. v. South American, etc. Co.* (1894), 1 Ch. 108; *Bank of Montreal v. Maritime Sulphite Fibre Co.*, 2 New Brunsw.

no event can the debenture-holders be deprived of the right to have a receiver charged with the duty of protecting their interests,¹ or be enjoined by the liquidator from proceeding with their suit.² Where different persons are receiver and liquidator, the receiver performs many of the duties that would ordinarily devolve on the liquidator; but some functions of the liquidator, such, for instance, as the making of calls on shareholders, can be exercised only by the liquidator, even though the debenture-holders through their receiver may be entitled to amounts realized by the liquidator.³ From the independent position which the debenture-holders occupy towards the winding-up proceedings, it follows that they cannot be called upon to pay any part of the costs of the winding-up,⁴ except indeed the "costs of realization" — that is, costs of sales or other proceedings that enure to their benefit.⁵

§ 1986. **In the United States.** — In the United States, while the distinction between a proceeding to foreclose a mortgage securing an issue of bonds and a proceeding for the winding-up and liquidation of the corporation is obscured by the fact that both are generally carried on simultaneously in the same court and are often consolidated into a single suit, yet the essential theoretical difference is as great as in England.⁶ The only exception to this statement is in the comparatively rare cases where by statute a sale by way of enforcement of the bondholders'

Eq. 328 (where in view of a dispute as to the validity and extent of the mortgage, the court thought that the bondholders and the general creditors should have different representatives).

¹ *Strong v. Carlyle Press* (1893), 1 Ch. 268.

But cf. *Central Trust Co. v. Wabash, etc. Ry. Co.*, 25 Fed. 693.

² *Longdendale Cotton Spinning Co.*, 8 Ch. D. 150.

³ See *Fowler v. Broad's Patent Night Light Co.* (1893), 1 Ch. 724; *Harrison v. St. Etienne Brewing Co.*, W. N. (1893) 108. Cf. *Engel v. South Metropolitan Co.* (1892), 1 Ch. 442.

⁴ *Anglo-Austrian Printing Union* (1895), 2 Ch. 891.

⁵ *Perry v. Oriental Hotels*, 12 Eq. 127. Cf. *Marine Mansions Co.*, 4 Eq. 601; *Regent's Canal Ironworks Co.*, 3 Ch. D. 411.

⁶ *St. Louis Car Co. v. Stillwater Street Ry. Co.*, 53 Minn. 129; *Decker v. Gardner*, 124 N. Y. 334; 26 N. E. 814; 11 L. R. A. 480; *Platt v. New York, etc. Ry. Co.*, 63 N. Y. App. Div. 401; 71 N. Y. Supp. 913 (holding that the right of a general statutory receiver or liquidator of a corporation to moneys earned by the corporation and therefore not subject to a mortgage securing an issue of bonds is superior to that of a receiver appointed on behalf of the bondholders in a foreclosure suit); *Conklin v. U. S. Shipbuilding Co.*, 140 Fed. 219 (headnote inadequate).

security *ipso facto* dissolves the corporation:¹ in such cases a suit to enforce the charge necessarily includes the winding-up of the company. Under some American winding-up acts, after a corporation has been dissolved, an independent proceeding to enforce the security of bondholders cannot be begun, the remedy being by petition filed in the winding-up suit.²

§ 1987. **Suits ancillary to Trustee's Power of taking Possession, making Sale, etc.** — In some cases, resort to the courts is had, not for the purpose of invoking the ordinary jurisdiction of chancery in respect to the foreclosure of mortgages, but in aid of powers to take possession and so forth conferred in the mortgage or deed of trust. Thus, the trustee under the mortgage, in whom a power to take possession of the mortgaged property is vested, has been allowed to maintain a bill in equity to recover possession, by way of enforcing specific performance of the contract;³ or if he wrongfully refuse to do so, a bill having a similar object may be maintained by the bondholders.⁴

§ 1988. **Suits for Administration of the Trust under the Supervision of the Court.** — Any such proceedings ancillary to the powers conferred on the trustee, as well as the more common bills for foreclosure and sale should be distinguished from a bill by the trustee of the mortgage praying that the court assume jurisdiction of the trust. A bill of this latter sort cannot, perhaps, be maintained unless some difficulty or complication has arisen, or is likely to arise, in the execution of the trust, or some dispute as to the powers or duties of the trustees or as to the rights of the persons beneficially interested.⁵ In any ordinary case, the

¹ Cf. *Holland v. Lee*, 71 Md. 338; 18 Atl. 661.

² *Nelson v. Hubbard*, 96 Ala. 238; 11 So. 428; 17 L. R. A. 375.

³ *McLane v. Placerville, etc. R. R. Co.*, 66 Cal. 606, 615; 6 Pac. 748; *Sacramento, etc. R. R. Co. v. Superior Court*, 55 Cal. 453; *Dow v. Memphis, etc. R. R. Co.*, 20 Fed. 260 (with which compare s. c. on appeal, 124 U. S. 652). Cf. *Shaw v. Norfolk, etc. R. R. Co.*, 5 Gray (Mass.) 162, 182—

183. As to the adequacy or inadequacy of the remedy by actions of ejectment and replevin to recover possession of the property, see *infra*, p. 1602, n. 4.

⁴ *Wilmer v. Atlanta, etc. Ry. Co.*, 2 Woods 409.

⁵ *Northern Central Ry. Co. v. Keighler*, 29 Md. 572 (headnote misleading).

Cf. *Craft v. Indiana, etc. Ry. Co.*, 166 Ill. 580; 46 N. E. 1132; *Guard-*

trustee has no occasion to seek the direction of the court unless a default has occurred. Until then his duties are purely passive. The impossibility of making all the *cestuis que trust*, namely, the bondholders, parties to such a bill would seem to constitute a serious obstacle to its maintenance, or at least narrows the relief which the court will grant.¹ The administration of the trust by the trustee may be controlled and supervised by a court of equity at the suit of one of the bondholders or *cestuis que trust*.²

§ 1989. **Suits by Trustee to recover Damages for Injuries to the Mortgaged Property.**— Another class of suits which should be distinguished from foreclosure proceedings, etc., consists in actions or suits on account of damage to the mortgaged property committed by a trespasser or tortfeasor.³

§ 1990. **Choice of Remedies.**— The bondholders or their trustee may usually pursue at their election any of the remedies open to them. The mere fact that a statute points out and sanctions one remedy does not impliedly prohibit other remedies that would otherwise be available. For instance, a statute providing that mortgagees may have a receiver appointed does not prevent them from applying to have the company wound-up and dissolved.⁴

§ 1991-§ 2018. RECEIVERS.

§ 1991. **In general — Distinguished from Statutory Liquidator.**— The first relief which is desired by the plaintiffs in a suit to enforce the security of bonds or debentures is, in almost all cases, the appointment of a receiver. A receiver so appointed is an ordinary chancery receiver, and must not be confused with a

ian Trust Co. v. White Cliffs, etc. Co., 109 Fed. 523, 527. Upon the general question as to the right of a trustee

to apply to a court of equity for directions in the administration of his trust in cases of doubt or difficulty, see 2 Perry on Trusts, 4th ed., § 928.

Fidelity, etc. Co. v. United Canal, etc. Co., 36 N. J. Eq. 405.

² *Bradley v. Chester Valley R. R. Co.*, 36 Pa. St. 141.

³ Cf. *Hubinger v. Central Trust Co.*, 94 Fed. 788; 36 C. C. A. 494; *Fidelity Trust Co. v. Hoboken, etc. R. Co.* (N. J.), 63 Atl. 273.

¹ Cf. *Clark v. St. Louis, etc. R. R. Co.*, 58 How. Pr. (N. Y.) 21; 1 I. R. 265.

⁴ *Porstewart Tramway Co.* (1896),

statutory liquidator.¹ The principles that govern his selection,² removal,³ powers, duties, liabilities, and so forth, are the same that apply to other receivers appointed under the ordinary powers of a court of equity, except in so far as differences are introduced by the peculiar nature of the property that he is called upon to deal with.

§ 1992–§ 1994. *When a Receiver will be appointed.*

§ 1992. **In general — When Principal or Interest is in Default.** — It is said that the appointment of a receiver to enforce the security of bondholders rests within the discretion of the court.⁴

¹ *United States Trust Co. v. New York, etc. Ry. Co.*, 101 N. Y. 478; 5 N. E. 316. See also *supra*, §§ 1983 et seq.

² As to who is a fit person to be receiver for mortgage bondholders, see *Atkins v. Wabash, etc. Ry. Co.*, 29 Fed. 161; *Fowler v. Jarvis Conklin Mge. Co.*, 63 Fed. 888; *Farmers' L. & T. Co. v. Northern Pac. R. R. Co.*, 61 Fed. 546; *Ralston v. Washington, etc. Ry. Co.*, 65 Fed. 557; *Farmers' L. & T. Co. v. Cape Fear, etc. R. R. Co.*, 62 Fed. 675; *State Trust Co. v. National Land, etc. Co.*, 72 Fed. 575; *Finance Co. v. Charleston, etc. R. Co.*, 45 Fed. 436; *Bowling Green Trust Co. v. Virginia Pass. etc. Co.*, 133 Fed. 186. As to converting the directors of the corporation into receivers, see § 1998.

After the appointment of a receiver for all the property of a corporation, the court will not ordinarily appoint a separate receiver for part of the property covered by an underlying mortgage securing an issue of bonds. *Clap v. Interstate Ry. Co.*, 61 Fed. 537. Cf. *supra*, § 1985. See also *Lloyd v. Chesapeake, etc. R. R. Co.*, 65 Fed. 351; *State Trust Co. v. National Land, etc. Co.*, 72 Fed. 575. That no provision in the mortgage can fetter

the judicial discretion so as to require the court to appoint as receiver any person nominated by the trustee, see *Citizens' Trust Co. v. Tompkins*, 97 Md. 183; 54 Atl. 617.

³ As to removal, see *Fowler v. Jarvis-Conklin Mge. Co.*, 63 Fed. 888; *Clarke v. Central R. R., etc. Co.*, 66 Fed. 16; *Continental Trust Co. v. Toledo, etc. R. Co.*, 59 Fed. 514; *Handy v. Cleveland, etc. R. R. Co.*, 31 Fed. 689; *Farmers' L. & T. Co. v. Northern Pac. R. R. Co.*, 61 Fed. 546; *Farmers' L. & T. Co. v. Cape Fear, etc. R. R. Co.*, 62 Fed. 675.

⁴ *Milwaukee, etc. R. R. Co. v. Soutter*, 2 Wall. 510; *Tyson v. Wabash Ry. Co.*, 8 Biss. 247; *Douglass v. Cline*, 12 Bush (Ky.) 608; *Farmers' L. & T. Co. v. Chicago, etc. Ry. Co.*, 27 Fed. 146.

A power on the part of the bondholders' trustee to take possession of the property has been thought to be an obstacle to the appointment of a receiver, see *Rice v. St. Paul, etc. R. R. Co.*, 24 Minn. 464. But it is difficult to see how the tedious process of numerous actions of ejectment and replevin can be deemed an adequate remedy for trustees under a deed of trust to secure an issue of bonds, and therefore a jus-

In one sense, this is true; but the proposition thus baldly stated is, to say the least, rather misleading. For under a corporation mortgage where the company has wide powers of dealing with the property in the course of its business, the appointment of a receiver to put a stop to this power would seem to be the absolute right of the bondholders when a proper case is made out. Such at least is the rule in England. Thus, holders of debentures secured by a floating charge are entitled to a receiver *ex debito justitiæ*, if the company has made default in payment of the principal,¹ or if, although the principal is not yet due, interest is in arrears.² If, however, the debentures provide that the principal shall become due if interest shall remain in arrears for six months, a receiver will not be appointed simply because interest had been overdue for three months, if the company has ceased to do business, so that little or no harm can result from delaying until the expiration of the six months.³

§ 1993. **When the Security is in Danger.** — Even though no default has occurred in respect to either principal or interest,

tification for the refusal to appoint a receiver. Cf. *Frapp v. Chard Ry. Co.*, 11 Hare, 241, 257; *Warner v. Rising Fawn Iron Co.*, 3 Woods, 514; *Dow v. Memphis, etc. R. R. Co.*, 20 Fed. 260 (with which cf. s. c. on appeal, 124 U. S. 652). See also supra, § 1965. As to bills in equity in aid of the trustee's powers to take possession of the property, and so forth, see supra, § 1987.

¹ *Hopkins v. Worcester, etc. Canal Proprietors*, 6 Eq. 437.

Cf. *Kelly v. Trustees of Ala., etc. R. R. Co.*, 58 Ala. 489, 500-501; *Haley v. Halifax Street Ry. Co.*, 25 Nova Scotia L. R. 140; *Warner v. Rising Fawn Iron Co.*, 3 Woods 514.

² *Bissell v. Bradford Tramway Co.*, W. N. (1891) 51; *Allan v. Manitoba, etc. Ry. Co.*, 10 Manitoba 106.

Cf. *McLane v. Placerville, etc. R. R. Co.*, 66 Cal. 606; 6 Pac. 748; *Kelly v. Trustees of Ala., etc. R. R. Co.*, 58 Ala. 489, 500-501; *Allan v. Dallas, etc. R. R. Co.*, 3 Woods 316; *Pullan v. Cincinnati, etc. R. R. Co.*,

4 Biss. 35, 47-50; *Farmers' L. & T. Co. v. Winona, etc. Ry. Co.*, 59 Fed. 957; *Mercantile Trust Co. v. Missouri, etc. Ry. Co.*, 36 Fed. 221.

But see *Tysen v. Wabash Ry. Co.*, 8 Biss. 247; *Williamson v. New Albany, etc. R. R. Co.*, 1 Biss. 198; *Union Trust Co. v. St. Louis, etc. R. R. Co.*, 4 Dill. 114; *Blair v. St. Louis, etc. Ry. Co.*, 20 Fed. 348; *American, etc. Trust Co. v. Toledo, etc. Ry. Co.*, 29 Fed. 416; *Romare v. Broken Arrow, etc. Mining Co.*, 114 Fed. 194; *Trust & Deposit Co. v. Spartanburg Waterworks Co.*, 91 Fed. 324 (headnote inadequate).

The appointment will be made without proof of a probable deficiency of the charged property to pay the debt secured. *Wilmer v. Atlanta, etc. Ry. Co.*, 2 Woods 409.

In *Williamson v. New Albany, etc. R. R. Co.*, 1 Biss. 198, the court, while refusing to appoint a receiver, ordered that the company set apart one-half of its net earnings for payment of interest on its bonds.

³ *Thorn v. Nine Reefs*, 67 L. T. 93.

nevertheless a receiver should be appointed if the security appears to be in danger;¹ but in order to determine whether or not the security is in such danger as to warrant the appointment of a receiver, much must be left to the judge's discretion, uncontrolled by hard and fast rules. If the company has ceased to do business, much difficulty will ordinarily be experienced in convincing the court that the security is in jeopardy.² Of course, where the security is threatened by some specific danger which may be prevented by an injunction, the court would ordinarily prefer to issue an injunction rather than adopt the more drastic remedy of a receivership.³ The fact that the property covered by the charge is in the possession or control of one set of bondholders who are hostile to another set is ground for the appointment of a receiver at the instance of one of the latter set.⁴

§ 1994. **Where the Company is in Liquidation or Insolvent.** — Another event that in England is held to necessitate a receiver for the debenture-holders is the commencement of liquidation or winding-up proceedings by or against the company.⁵ Probably, the same conclusion would be reached in the United States, except that, because of the obscurity of the distinction between a winding-up and a suit to enforce the security of mortgagees,

¹ *McMahon v. North Kent Ironworks Co.* (1891), 2 Ch. 148; *Edwards v. Standard Rolling Stock Syndicate* (1893), 1 Ch. 574; *London Pressed Hinge Co.* (1905), 1 Ch. 576; *Farmers' L. & T. Co. v. Meridian Waterworks Co.*, 139 Fed. 661 (where a decree in a suit against the company depriving it of the possession of the property was held ground for appointing a receiver).

Cf. *Allen v. Dallas, etc. R. R. Co.*, 3 Woods 316; *State v. Northern Central Ry. Co.*, 18 Md. 193; *Long Dock Co. v. Mallery*, 12 N. J. Eq. 431; *Ralph v. Wisner*, 100 Mich. 164; 58 N. W. 837; *Kennedy v. St. Paul, etc. R. R. Co.*, 2 Dill. 448; *Brussey v. New York, etc. R. R. Co.*, 19 Fed. 663.

But see *Union Mutual Life Ins. Co. v. Union Mills Plaster Co.*, 37

Fed. 286; 3 L. R. A. 90 (where the court refused a receiver, but granted an injunction against disposing of the assets by way of dividends or otherwise without an order of court); *American, etc. Trust Co. v. Toledo, etc. Ry. Co.*, 29 Fed. 416 (mere threatened mismanagement by the company held insufficient ground for appointment of receiver).

² *Thorn v. Nine Reefs*, 67 L. T. 93.

³ Cf. *Wildy v. Mid-Hants Ry. Co.*, 18 L. T. 73; *Union Mutual Life Ins. Co. v. Union Mills Plaster Co.*, 37 Fed. 286 (stated *supra*, note 1).

⁴ *Benedict v. St. Joseph, etc. R. R. Co.*, 19 Fed. 173.

⁵ *Wallace v. Universal Automatic Machine Co.* (1894), 2 Ch. 547; *Victoria Steamboats* (1897), 1 Ch.

a simpler course seems to be to intrust to the "receiver" who has been charged with the duties and powers of a statutory liquidator the additional functions of a receiver for the bondholders.

The mere fact that the company is insolvent is not sufficient ground for the appointment of a receiver when the management is honest and prudent, and when the earnings are increasing.¹

§ 1995-§ 1999. *Empowering Receiver to carry on the Business.*

§ 1995. **English Distinction between a mere "Receiver" and a "Receiver and Manager."** — In England a distinction is taken between a mere receiver and a receiver and manager.² A mere receiver has no duty or power to manage the company's business: his sole function is, as his name implies, to receive the income from the business. The management of the business, the appointment and discharge of agents, etc., is left in charge of the directors and officers of the corporation, who turn over the receipts to the receiver. The functions of a receiver are those of a mere treasurer.³ A receiver and manager, on the other hand, takes full control of the business, appoints and discharges agents, makes contracts, and superintends their execution.⁴ In America the term "receiver," as applied to the receiver of a corporation, means a "receiver and manager," and will be so used in this treatise.

§ 1996. **Power to appoint a Receiver and Manager for a Public-Service Company.** — The English courts of equity declined, in a suit by debenture-holders to enforce their security, to assume jurisdiction to appoint a "receiver and manager" for a railway or similar public-service corporation; ⁵ or to decree a sale of its

¹ *Trust & Deposit Co. v. Spartanburg Waterworks Co.*, 91 Fed. 324. As to insolvency of the company as ground for appointment of a receiver at the instance of bondholders, see further *Des Moines Gas Co. v. West*, 44 Iowa 23.

² See Palmer's *Company Precedents*, Part III, 9th ed., 424.

³ *Ames v. Birkenhead Docks*, 20 Beav. 332, 351.

⁴ Where a receiver has been ap-

pointed generally but with authority to act as manager until a certain date, and it is desired to continue his management of the business, the correct English practice is simply to extend the time during which the receiver is to act as manager. *Davies v. Vale of Evesham Preserves*, 73 L. T. 150.

⁵ *Gardner v. London, etc. Ry. Co.*, 2 Ch. 201; *Blaker v. Herts, etc. Waterworks Co.*, 41 Ch. D. 399. So

undertaking;¹ for, they argued, to do so would amount to taking the control of a public undertaking out of the hands of those persons to whom the legislature by the act of incorporation had intrusted it. The force of this argument has been fully felt in the United States; but our courts have avoided its effect by holding that when the legislature authorizes a public-service corporation to mortgage its business — and any such mortgage is illegal without direct legislative authority — the possibility of the business first passing into the hands of a managing receiver and finally being sold must be taken to have been within the legislature's contemplation, and therefore impliedly sanctioned.² Even in England, a statute has conferred upon the courts the same jurisdiction to appoint a managing receiver for railways that they exercise in respect to companies having no public duties to perform.³

§ 1997. **Reluctance of Courts to undertake or continue Management of Business through a Receiver.** — Nevertheless, the appointment of a managing receiver, involving as it does the assumption by the court of the unwelcome task of superintending the business, is naturally made with reluctance.⁴ Indeed, it has been said that the court will appoint a receiver and manager for a corporation only when a sale of its undertaking is in view,⁵ and only when the charge or mortgage to be enforced covers the business or goodwill of the company.⁶ At all events, the court will seek to be rid of the job of managing a business as soon as possible. Thus, in an English case, the court refused to appoint a receiver and manager with power to carry on the business

in *Manitoba: Allan v. Manitoba, etc. Ry. Co.*, 10 *Manitoba* 106. But see *Fripp v. Chard Ry. Co.*, 11 *Hare* 241.

¹ *Blaker v. Herts, etc. Waterworks Co.*, 41 *Ch. D.* 399; *Marshall v. South Staffordshire Tramways Co.* (1895), 2 *Ch.* 36.

² *Vicksburg v. Vicksburg Waterworks Co.*, 202 *U. S.* 453; 26 *Sup. Ct.* 660; *Willink v. Morris Canal, etc. Co.*, 4 *N. J. Eq.* 377, 404. Cf. *Palmer v. Forbes*, 23 *Ill.* 301. The same reasoning has prevailed in *Ontario Toronto Gen. Trusts Corp. v. Central Ontario Ry. Co.*, 6 *Ont. L. R.* 1.

³ 30 & 31 *Vict. c.* 127. See *Eastern & Midlands Ry. Co.*, 45 *Ch. D.* 367.

⁴ *Meyer v. Johnston*, 53 *Ala.* 237; *International Trust Co. v. Decker Bros.*, 152 *Fed.* 78 (headnote inadequate).

⁵ *Victoria Steamboats* (1897), 1 *Ch.* 158.

But see *McLane v. Placerville, etc. R. R. Co.*, 66 *Cal.* 606, 615-616; 6 *Pac.* 748.

⁶ *Leas Hotel Co.* (1902), 1 *Ch.* 332.

indefinitely, but provided that he should not carry on the business for more than six months without a further order of court.¹ On the other hand, the court in its anxiety to rid itself of the management of the company will not terminate the receivership by directing a sale before the object of the receivership has been attained by the completion of the road so as to earn certain subsidies.² The appointment of a receiver to carry on the business will not be refused merely because the enterprise cannot be successfully prosecuted without the use of certain property which is not covered by the charge.³

§ 1998. **Order converting Directors into Receivers.** — An order directing that the president and directors, under the order of and subject to the court, shall continue in the possession and management of the property and business of the company has been held sufficient to constitute the president and directors receivers.⁴ Ordinarily, an officer or director of the corporation should not be selected as receiver.⁵

§ 1999. **Authorizing Receiver to do anything that a prudent Manager of the Business might do.** — The court may authorize the receiver and manager to do whatever the company as a prudent manager of its own business, had its possession not been displaced, might have done.⁶ Hence, it may authorize the receiver of a railroad company to take a lease of a connecting railroad or to aid in constructing a subsidiary line.⁷ So, the court may direct the receiver to pay full wages to an employee during the time the latter was incapacitated from service by injuries re-

¹ *Day v. Sykes, etc. Co.*, 55 L. T. 177 Ill. 427; 53 N. E. 73 (condemnation of private property). Cf. 763.

² *Bibber-White Co. v. White River, etc. R. Co.*, 110 Fed. 473. See *infra*, § 2022. *Kansas Pac. Ry. Co. v. Bayles*, 19 Colo. 348, 353-354; 35 Pac. 744.

³ *Haley v. Halifax Street Ry. Co.*, 25 Nova Scotia 140, 148. As to the extent of a receiver's general authority to contract, see *infra*, § 2047, and as to his power to borrow, see *infra*, § 2049 et seq.

⁴ *Re Fifty-four First Mortgage Bonds*, 15 S. Car. 304. Cf. *Ex parte Williams*, 17 S. Car. 396.

⁵ *Coy v. Title Guarantee, etc. Co.*, 157 Fed. 794. ⁷ *Gibert v. Washington City, etc. R. R. Co.*, 33 Gratt. (Va.) 586; *Mercantile Trust Co. v. Missouri, etc. Ry. Co.*, 41 Fed. 8, 11-12.

⁶ *Eastern & Midlands Ry. Co. (2)*, 66 L. T. 153; *Morrison v. Forman*, 1607

ceived in the course of his duty, but without negligence on the part of the receiver.¹

§ 2000. Of what Property the Receiver should take Possession.

— A receiver appointed for the purpose of enforcing the security of bonds or debentures should ordinarily be directed to take possession of all property covered by the charge. If other language is used, his powers may prove to be unexpectedly and unfortunately circumscribed. For instance, a receiver authorized to take possession of all property owned by the mortgagor company cannot recover possession of property which before his appointment had been sold under an execution against the company; for, whether or not such execution sale defeated the rights of the bondholders, the property sold was not *owned* by the company at the time of the receiver's appointment.² Of course, the court should take care that the receiver does not assume possession of property which is not covered by the mortgage, and should not construe its order as authorizing him to do so.³ If the receiver does take possession of property not covered by the mortgage, the court should promptly permit any creditors having liens thereon to enforce the same.⁴

§ 2001–§ 2006. Relation between the Receiver and the Corporation.

§ 2001. Liability of the Corporation for Acts and Contracts of Receiver. — The management of the business by a receiver is

¹ *Missouri Pac. Ry. Co. v. Texas, etc. Ry. Co.*, 33 Fed. 701. Cf. *supra*, § 87 and § 1958.

² *McIlrath v. Snure*, 22 Minn. 391. Cf. *Gabert v. Olcott* (Tex.), 22 S. W. Rep. 286.

³ *Central Trust Co. v. Worcester Cycle Mfg. Co.*, 114 Fed. 659. Cf. *Bank of Montreal v. Maritime Sulphite Fibre Co.*, 2 New Brunsw. Eq. 328 (where the court amended its order so as to make clear that the receiver was not to take possession

of property not covered by the charge).

⁴ *Scott v. Farmers' L. & T. Co.*, 69 Fed. 17; 16 C. C. A. 358. Cf. *Mercantile, etc. Trust Co. v. Baltimore, etc. R. R. Co.*, 79 Fed. 389; *Hook v. Bosworth*, 64 Fed. 443; 12 C. C. A. 208; *Central Trust Co. v. Worcester Cycle Mfg. Co.*, 114 Fed. 659.

But see *Farmers' L. & T. Co. v. San Diego Street-Car Co.*, 49 Fed. 188; *Rumsey v. People's Ry. Co.*, 91 Mo. App. 202.

equivalent to the management by the court itself. The receiver is not the agent of the company but of the court. Hence, he has no power to bind the company by contract.¹ For this reason where a receiver of a railway company has been discharged and possession of the roadway restored to the corporation, the latter is not bound to honor tickets issued by the receiver.²

Nor is the company liable for the negligence of the receiver or his servants in the conduct of the business,³ or for their failure to perform some statutory duty;⁴ but the company will be liable for any damage which may be sustained after the receivership in consequence of a wrongful act or breach of duty committed prior to the appointment of the receiver.⁵ Moreover, even a statute making a railway company which has leased its line liable for torts committed by the agents or employees of the lessee does not subject the lessor to liability for acts of the receiver of the lessee company or his employees.⁶

In order, however, that the company should be relieved from liability because of the receiver's possession, the latter's possession and control must be exclusive and public. For instance, where the railway is operated jointly by the receiver of part of it and the lessees of the remainder, and where tickets are issued in the name of the corporation and not of the receiver, the com-

¹ *Reid v. Explosives Co.*, 19 Q. B. D. 264, 268.

² *Godfrey v. Ohio, etc. Ry. Co.*, 116 Ind. 30; 18 N. E. 61.

³ *Texas, etc. Ry. Co. v. Huffman*, 83 Tex. 286; 18 S. W. 741; *Texas, etc. Ry. Co. v. Bledsoe*, 2 Tex. Civ. App. 88; 20 S. W. 1135; *Memphis, etc. Ry. Co. v. Stringfellow*, 44 Ark. 322; 51 Am. Rep. 598; *Kansas, etc. Ry. Co. v. Dorough*, 72 Tex. 108, 111; 10 S. W. 711 (semble); *Chamberlain v. New York, etc. R. R. Co.*, 71 Fed. 636; *Davis v. Duncan*, 19 Fed. 477; *Memphis, etc. R. R. Co. v. Hoechner*, 67 Fed. 456; 14 C. C. A. 469; *Stevens v. Atchison, etc. Ry. Co.*, 87 Mo. App. 26; *Missouri, etc. Ry. Co. v. Wood (Tex.)*, 52 S. W. 93.

But see *Texas, etc. Ry. Co. v. Johnson*, 151 U. S. 81, 99; 14 Sup. Ct. 250. The receiver cannot be

made a co-defendant in an action against the company. *Rogers v. Mobile, etc. R. R. Co.*, 12 Am. & Eng. R. R. Cas. 442 (Tenn.).

⁴ *Schurr v. Omaha, etc. Ry. Co.*, 98 Iowa 418; 67 N. W. 280; *Brockert v. Central Iowa Ry. Co.*, 82 Iowa 369; 47 N. W. 1026.

But see *Ohio, etc. Ry. Co. v. Russell*, 115 Ill. 52; 3 N. E. 561; *Harris v. Quincy, etc. Ry. Co. (Mo.)*, 101 S. W. 601.

⁵ *Union Trust Co. v. Cuppy*, 26 Kans. 754; *Kansas Pac. Ry. Co. v. Wood*, 24 Kans. 619.

⁶ *Chamberlain v. New York, etc. R. R. Co.*, 71 Fed. 636. As to the liability of a lessor for damage caused by the operation of a railway by the receiver of the lessee, see further, *Harris v. Quincy, etc. Ry. Co. (Mo.)*, 101 S. W. 601.

pany is liable for an injury to a passenger who had no knowledge of the receivership.¹

Sometimes, where a receiver has been discharged and the assets redelivered to the company with betterments produced by the receiver's earnings, the company has been thought to undergo an equitable obligation to respond for the receiver's actions, upon the ground that having received benefits from the receivership, it should also bear the burdens thereof.² And the court in ordering the restoration of the property to the company may require the company to assume as a condition of the restoration liability for claims incurred by the receiver.³

§ 2002. **Effect of Appointment of Receiver on Powers of the Corporation.** — As a receiver appointed in a suit to enforce the security of bonds or debentures is not in law the representative of the company, the mere appointment of such a receiver does not prevent the company from holding elections and indeed prosecuting its business, except that the possession and control of the mortgaged property must in nowise be interfered with.⁴ So also, while the court upon appointing such a receiver may enjoin the further prosecution of any suits against the company, yet the mere appointment of a receiver does not have that effect.⁵ In some of these respects, the appointment of such a receiver differs from the appointment of a statutory receiver or liquidator.

¹ *Railroad Co. v. Brown*, 17 Wall. 445.

² *Texas, etc. Ry. Co. v. Huffman*, 83 Tex. 286; 18 S. W. 741 (semble); *Texas, etc. Ry. Co. v. Watts*, 18 S. W. Rep. 312 (Tex.); *Mobile, etc. R. R. Co. v. Davis*, 62 Miss. 271; *Texas, etc. Ry. Co. v. Gaal*, 37 S. W. Rep. 462; 14 Tex. Civ. App. 459; *Texas, etc. Ry. Co. v. Geiger*, 79 Tex. 13; 15 S. W. 214; *Texas, etc. Ry. Co. v. Bloom*, 60 Fed. 979; 9 C. C. A. 300.

Cf. Houston, etc. Ry. Co. v. Strycharski, 35 S. W. Rep. 851 (Tex.); *Texas, etc. Ry. Co. v. Johnson*, 151 U. S. 81; 14 Sup. Ct. 250; *Bayles v. Kansas Pac. Ry. Co.*, 13 Colo. 181; 22 Pac. 341; 5 L. R. A. 480; *Ryan v. Hays*, 62 Tex. 42;

Missouri, etc. Ry. Co. v. Wood (Tex.), 52 S. W. 93 (company exonerated because betterments by receiver not established).

A judgment against the company based upon this ground must not exceed in amount the value of the property delivered over to the company by the receiver. *Missouri, etc. Ry. Co. v. Wylie* (Tex.), 33 S. W. Rep. 771.

³ *Baltimore, etc. R. R. Co. v. Burris*, 111 Fed. 882; 50 C. C. A. 48.

⁴ *Decker v. Gardner*, 124 N. Y. 334; 26 N. E. 814; 11 L. R. A. 480.

⁵ *Allen v. Central R. R. Co.*, 42 Iowa 683; *Finance Co. v. Charleston, etc. R. Co.*, 46 Fed. 508.

§ 2003. **Liability of Receiver on the Company's Leases and other Contracts.** — The receiver is not bound by the leases and other contracts of the company, unless he elect to adopt them. Of course, this proposition does not mean that the appointment of a receiver operates to relieve the corporate assets from the burden of the company's contracts; for, notwithstanding the appointment of a receiver, the company and its assets continue to be bound by its contracts,¹ but the contracts cannot be treated as contracts of the receiver so as to take priority over the bonds or debentures in the interest of which the receiver was appointed. It is only when the receiver elects to adopt a lease or other contract that it becomes his own obligation, and as such a preferred claim against the assets in his hands.² To make his election he is allowed a reasonable time. Hence, he is not bound by a lease which the company held merely because he continued in possession of the demised premises for a reasonable time before repudiating the lease;³ and the courts have been very lenient towards

¹ Cf. *Scott v. Rainier, etc. Ry. Co., Farmers' L. & T. Co.*, 79 Fed. 158; 13 Wash. 108; 42 Pac. 531; *New York, etc. R. R. Co. v. New York, etc. R. R. Co.*, 58 Fed. 268; *Central Trust Co. v. East Tennessee Land Co.*, 79 Fed. 19.

² *Quincy, etc. R. R. Co. v. Humphreys*, 145 U. S. 82; 12 Sup. Ct. 787; *St. Joseph, etc. R. R. Co. v. Humphreys*, 145 U. S. 105; 12 Sup. Ct. 795; *United States Trust Co. v. Wabash, etc. Ry. Co.*, 150 U. S. 287; 14 Sup. Ct. 86; *Scott v. Rainier, etc. Ry. Co.*, 13 Wash. 108; 42 Pac. 531; *Spencer v. Brooks*, 97 Ga. 681; 25 S. E. 480; *Casey v. Northern Pac. R. R. Co.*, 48 Pac. 53; 15 Wash. 450; *Brown v. Warner*, 78 Tex. 543; 14 S. W. 1032; 22 Am. St. Rep. 67; 11 L. R. A. 394; *New York, etc. R. R. Co. v. New York, etc. R. R. Co.*, 58 Fed. 268 (disapproving *Brown v. Toledo, etc. R. Co.*, 35 Fed. 444); *Central Trust Co. v. East Tennessee Land Co.*, 79 Fed. 19; *Olyphant v. St. Louis, etc. Steel Co.*, 28 Fed. 729.

But see *Howe v. Harding*, 76 Tex. 17; 13 S. W. 41; 18 Am. St. Rep. 17. Cf. *Woodruff v. Erie Ry. Co.*, 93 N. Y. 609; *Central R. R., etc. Co. v. Farmers' L. & T. Co.*, 79 Fed. 158; 42 Pac. 531; *New York, etc. R. R. Co. v. New York, etc. R. R. Co.*, 58 Fed. 268; *Central Trust Co. v. Continental Trust Co.*, 86 Fed. 517; 30 C. C. A. 235; in which cases the receiver was held to have elected to accept a lease. See also *Mercantile Trust Co. v. St. Louis, etc. Ry. Co.*, 71 Fed. 601; *Grand Trunk Ry. Co. v. Central Vt. R. R. Co.*, 81 Fed. 541.

In *Wabash, etc. Ry. Co. v. Central Trust Co.*, 22 Fed. 269; *Central Trust Co. v. Ohio Central Ry. Co.*, 23 Fed. 306, 310, receivers were held to have elected to adopt a contract made by the company.

As to contracts between the company and its employees, see *infra*, § 2006.

³ *Quincy, etc. R. R. Co. v. Humphreys*, 145 U. S. 82; 12 Sup. Ct. 787; *St. Joseph, etc. R. R. Co. v. Humphreys*, 145 U. S. 105; 12 Sup. Ct. 795; *United States Trust Co. v. Wabash, etc. Ry. Co.*, 150 U. S. 287; 14 Sup. Ct. 86; *Carswell v. Farmers' L. & T. Co.*, 74 Fed. 88; 20 C. C. A. 282;

the receiver in passing upon the question whether or not a reasonable time to make his election had elapsed before his abandonment of the property.¹ Of course, he is liable for the fair rental value of the property during the time he is in possession;² and in one case of somewhat exceptional circumstances was held for the contract rental during the period of his possession.³ Moreover, where the leased premises, the plant of a rival concern, were purchased by the company for the purpose of keeping them idle and thus preventing competition, a receiver who pursues the same policy may be held to have elected to abide

Park v. New York, etc. R. Co., 57 Fed. 799; *New York, etc. R. R. Co. v. New York, etc. R. R. Co.*, 58 Fed. 268; *Ames v. Union Pac. Ry. Co.*, 60 Fed. 966; *Platt v. Philadelphia, etc. R. R. Co.*, 84 Fed. 535; 28 C. C. A. 488.

Cf. *Hay v. Swedish, etc. Ry. Co.*, 8 Times L. R. 775; *Kneeland v. American Loan Co.*, 136 U. S. 89; 10 Sup. Ct. 950.

¹ *Quincy, etc. R. R. Co. v. Humphreys*, 145 U. S. 82; 12 Sup. Ct. 787; *St. Joseph, etc. R. R. Co. v. Humphreys*, 145 U. S. 105; 12 Sup. Ct. 795; *United States Trust Co. v. Wabash, etc. Ry. Co.*, 150 U. S. 287; 14 Sup. Ct. 86; *Carswell v. Farmers' L. & T. Co.*, 74 Fed. 88; 20 C. C. A. 282.

Cf. *Myer v. Car Co.*, 102 U. S. 1; *Charlotte, etc. R. R. Co. v. Chester, etc. R. R. Co.*, 24 S. E. Rep. 769 (N. Car.); 118 N. Car. 1078; *Thomas v. Cincinnati, etc. Ry. Co.*, 77 Fed. 667.

The retention of possession of personal property which had been leased to the company cannot be treated as a conversion thereof. *Farmers' L. & T. Co. v. Chicago, etc. Ry. Co.*, 42 Fed. 6.

² *Thomas v. Western Car Co.*, 149 U. S. 95; 13 Sup. Ct. 824; *Kneeland v. Am. Loan Co.*, 136 U. S. 89; 10 Sup. Ct. 950; *Lane v. Macon, etc. Ry. Co.*, 96 Ga. 630; 24 S. E. 157; *Carswell v. Farmers' L. & T. Co.*, 74 Fed. 88; 20 C. C. A. 282; *Farm-*

ers' L. & T. Co. v. Chicago, etc. Ry. Co., 42 Fed. 6; *Savannah, etc. Ry. Co. v. Jacksonville, etc. Ry. Co.*, 79 Fed. 35; 24 C. C. A. 437; *Platt v. Philadelphia, etc. R. R. Co.*, 84 Fed. 535; 28 C. C. A. 488.

Cf. *Quincy, etc. R. R. Co. v. Humphreys*, 145 U. S. 105; 12 Sup. Ct. 787; where the court seems to have come to the conclusion that since the property demised did not pay expenses its fair rental value was nil.

See also *United States Trust Co. v. Wabash, etc. Ry. Co.*, 150 U. S. 287; 14 Sup. Ct. 86; *Central Trust Co. v. Wabash, etc. Ry. Co.*, 23 Fed. 863; *Howe v. Harding*, 76 Tex. 17; 13 S. W. 41; 18 Am. St. Rep. 17; *Park v. New York, etc. R. Co.*, 57 Fed. 799; *Ames v. Union Pac. Ry. Co.*, 60 Fed. 966, 973 (headnote inadequate); *Cox v. Terre Haute, etc. R. R. Co.*, 133 Fed. 371; 66 C. C. A. 433.

³ *Farmers' L. & T. Co. v. Northern Pac. R. R. Co.*, 58 Fed. 257. Cf. *Clyde v. Richmond, etc. R. R. Co.*, 63 Fed. 21.

Where at the appointment of a receiver, work was being done by a contractor under a contract with the company, the receiver must pay at the contract price for work done after the receiver's appointment and before his repudiation of the contract. *Girard, etc. Trust Co. v. Cooper*, 51 Fed. 332; 2 C. C. A. 245.

by the lease, although he never takes actual possession of the premises.¹ It has been held that a receiver has no power to adopt contracts of the company except so far as they serve the purposes of his appointment, namely, the carrying on of the business of the company and the preservation of the security.²

§ 2004. **Liability of Receiver for Torts of the Corporation.** — As the receiver is not liable upon contracts made by the corporation unless he adopt them, so neither can he be sued for torts committed by the company prior to his appointment.³ Upon all such claims, the only remedy is by action against the company, or by proving the claims in the receivership case if the receiver has in his hands any assets applicable to their payment.⁴

§ 2005. **Effect upon Receiver of Judgments against the Company.** — A receiver is not ordinarily bound by a judgment against the company; but where a judgment or decree against the company relates to the mode of enjoyment of its property, the receiver must either comply with the judgment or decree or surrender the property to which it relates.⁵ Moreover, any judgment against the company conclusively establishes a claim as a liability of the corporation, and the receiver cannot dispute its validity except for fraud in its obtention. The judgment is not, however, an obligation of the receiver so as to be a preferred claim on assets in his hands.

§ 2006. **Effect of Appointment of Receiver on Agents and Servants of the Company.** — In England, the appointment of a receiver to manage the business of a corporation is thought to operate as a dismissal of all the servants of the corporation.⁶ For, it is said, they cannot continue to be servants of the company, since the appointment of the receiver deprives the company of power to carry on its business; and they certainly cannot be servants of the receiver unless he chooses to employ them. Moreover, it has been said that since this dismissal was caused by

¹ *Dayton Hydraulic Co. v. Fil-senthall*, 116 Fed. 961; 54 C. C. A. 537. *R. R. Co. v. Heflin*, 83 Fed. 93; 27 C. C. A. 460.

² *Whightsel v. Felton*, 95 Fed. 923 (contract to retain employees in service in compromise of a claim for damages for personal injuries). ⁴ *Decker v. Gardner*, 124 N. Y. 334; 26 N. E. 814; 11 L. R. A. 480. But see *Combs v. Smith*, 78 Mo. 32.

³ *Finance Co. v. Charleston, etc.* ⁵ *Peckham v. Dutchess Co. R. R. Co.*, 145 N. Y. 385; 40 N. E. 15. ⁶ *Reid v. Explosives Co.*, 19 R. Co., 46 Fed. 508; *Northern Pac. Q. B. D.* 264.

the company's own default in failing to pay its secured indebtedness, the discharged servants could recover damages therefor from the company.¹

One cannot say with certainty whether these views would be adopted to their full extent by the American courts.² In Colorado it has been held that an agent of the company who is retained by the receiver in his employ has the same powers as before the appointment of the receiver.³ It is clear that a receiver is no more bound by the contracts of the corporation with its employees than by its contracts with other persons; and hence a receiver is not affected by a stipulation in a contract of employment whereby the employee should not be discharged except for cause to be determined by arbitrators.⁴

§ 2007-§ 2015. LIABILITY OF RECEIVER TO THIRD PERSONS FOR ACTS DONE IN THE CONDUCT OF THE BUSINESS.

§ 2007-§ 2008. *English Doctrine of Personal Liability of Receiver.*

§ 2007. **Contracts.** — The receiver is, according to the English view, liable personally upon all contracts that he makes.⁵ The course of reasoning is this: someone must be liable on the receiver's contracts. It cannot be the company, for the receiver is not the agent of the company. It certainly cannot be the court, although the court is the receiver's real principal.⁶ Hence, it can only be the receiver himself. Against any liability which he may thus incur, the court will of course take care that he be indemnified out of the assets in his hands. The terms of the contract may exclude this individual liability, the contractor agreeing to

¹ *Reid v. Explosives Co.*, 19 Q. B. D. 264.

² Cf. *Spencer v. Brooks*, 97 Ga. 681; 25 S. E. 480; *Commonwealth Roofing Co. v. North American Trust Co.*, 135 Fed. 984; 68 C. C. A. 418; *Venner v. Denver Union Water Co.* (Colo.), 90 Pac. 623 (holding that appointment of officer as receiver does not affect his capacity as agent of the company to receive service of process).

³ *Kansas Pac. Ry. Co. v. Bayles*, 19 Colo. 348; 35 Pac. 744.

⁴ *Seattle, etc. Ry. Co.*, 61 Fed. 541.

⁵ *Burt v. Bull* (1895), 1 Q. B. 276.

Cf. *Hand v. Blow*, 82 L. T. 750.

⁶ But see *Glasdir Copper Mines* (1906), 1 Ch. 365, 378 (where Vaughan-Williams, L. J., said that a receiver for debenture holders is "not an agent to contract, either of the court or of anybody else, but is a principal").

look to the receiver's assets alone.¹ Such a stipulation cannot be inferred from a signature of the contract in the following form, "J. B. S. Co., Receivers and Managers, E. C. B. & R. J. W." ²

§ 2008. **Torts.** — The receiver's liability for torts committed in the conduct of the business would seem to rest upon the same ground. For any tort in which the receiver personally participated, he would undoubtedly be liable individually; and even where the tort is committed by his agents in the scope of their authority in the conduct of the business but without his personal participation, he would be liable, if the above statement of the law is correct, and would have the right to indemnification out of the assets.

§ 2009-§ 2010. *American Doctrine.*

§ 2009. **Only the Assets Liable.** — Whilst the reasoning which leads to these conclusions as to a receiver's personal liability, whether sounding in contract or tort, is difficult to resist, yet the American cases take the view that the receiver is not personally liable for contracts made or torts committed in the course of his management of the business, but that only the assets in his hands are answerable. As Mr. Justice Brown, speaking for the Supreme Court, said: "Actions against the receiver are in law actions against the receivership, or the funds in the hands of the receiver, and his contracts, misfeasances, negligences and liabilities are official and not personal, and judgments against him as receiver are payable only from the funds in his hands." ³ For this reason it has been held that a receiver as representing the property in his hands is liable though the cause of action arose during the receivership of a predecessor in the office.⁴ "His posi-

¹ *Glasdir Copper Mines* (1906), 188; *Camp v. Barney*, 4 Hun (N. Y.) 1 Ch. 365.

² *Burt v. Bull* (1895), 1 Q. B. 276.

³ *McNulta v. Lochridge*, 141 U. S. 327, 332; 12 Sup. Ct. 11. See also *Texas, etc. Ry. Co. v. Cox*, 145 U. S. 593, 601; 12 Sup. Ct. 905; *Bartlett v. Keim*, 50 N. J. Law 260, 261; 13 Atl. 7 (semble); *Meara's Admr. v. Holbrook*, 20 Oh. St. 137; 5 Am. Rep. 633; *Vanderbilt v. Central R. R. Co.*, 43 N. J. Eq. 669; 12 Atl.

188; *Camp v. Barney*, 4 Hun (N. Y.) 373; *Farmers' L. & T. Co. v. Central R. R. of Iowa*, 7 Fed. 537; *Davis v. Duncan*, 19 Fed. 477; *State v. Port Royal, etc. Ry. Co.*, 84 Fed. 67.

Cf. *Melendy v. Barbour*, 78 Va. 544; *Turner v. Indianapolis, etc. Ry. Co.*, 8 Biss. 527; *Kain v. Smith*, 80 N. Y. 458; *Erschine v. McIlrath*, 60 Minn. 485; 62 N. W. 1130.

⁴ *McNulta v. Lochridge*, 141 U. S. 327; 12 Sup. Ct. 11. Cf. *Vanderbilt v. Central R. R. Co.*, 43 N. J. Eq.

tion," said the court, "is somewhat analogous to that of a corporation sole." According to this doctrine, when a receiver has been formally discharged, his liability is at an end.¹

§ 2010. **Exceptional Cases in which Receivers are liable Personally.** — Of course, all authorities agree that a receiver is personally liable for all torts in which he personally participates,² or for debts which he contracts through personal mismanagement.³ Moreover, if the receiver remains in possession and management of the property after final ratification of the sale thereof, he does so either individually or as agent for the purchaser, and in either case is personally liable for torts committed by servants in the conduct of the business.⁴

§ 2011-§ 2014. *Suits against Receiver.*

§ 2011. **Of the Doctrine that the Receiver cannot be sued without Leave of the Court which appointed him.** — When it is said that a receiver is liable as custodian of the corporate assets, for contracts made or torts committed in the conduct of the business by him or his agents, it is not meant that he can be sued therefor without first obtaining leave to do so. On the contrary, the general principle is that no receiver can be sued without leave of the court by which he was appointed,⁵ and this principle will consti-

669; 12 Atl. 188; *Jones v. Schlappack*, 81 Fed. 274.

But see *Kansas Pac. Ry. Co. v. Bayles*, 19 Colo. 348.

¹ *Infra*, § 2015.

² *Bank of Montreal v. Thayer*, 7 Fed. 622.

³ *Gutterson v. Lebanon Iron, etc. Co.*, 151 Fed. 72.

⁴ *Larsen v. U. S. Mortgage, etc. Co.*, 104 N. Y. App. Div. 76; 93 N. Y. Supp. 610.

⁵ *Melendy v. Barbour*, 78 Va. 544; *Thompson v. Scott*, 4 Dill. 508; *De Graffenried v. Brunswick, etc. R. R. Co.*, 57 Ga. 22; *Kennedy v. I. C. & L. R. Co.*, 3 Fed. 97.

But see *Allen v. Central R. R. Co.*, 42 Iowa 683, 687-688; *Blumenthal v. Brainerd*, 38 Vt. 402; 91 Am. Dec. 349; *Newell v. Smith*, 49 Vt. 255;

Little v. Dusenbury, 46 N. J. Law 614; 50 Am. Rep. 445.

As to whether the chancellor upon application being made to him should grant leave to sue the receiver at law or should himself adjudicate upon the validity of the claim, see *Palys v. Jewett*, 32 N. J. Eq. 302; *Thompson v. Scott*, 4 Dill. 508; *Pacific Ry. Co. v. Wade*, 91 Cal. 449; 27 Pac. 768; 13 L. R. A. 754; 25 Am. St. Rep. 201; *Vanderbilt v. Central R. R. Co.*, 43 N. J. Eq. 669; 12 Atl. 188; *Brocklebank v. East London Ry. Co.*, 48 L. J. Ch. 729; *Klein v. Jewett*, 26 N. J. Eq. 474. Cf. *Hayes v. Columbus, etc. Ry. Co.*, 67 Fed. 630; *Buckhannon, etc. R. Co. v. Davis*, 135 Fed. 707; 68 C. C. A. 345.

As to what amounts to sufficient

tute a defence to an action at law even in a foreign court brought without such leave.¹ This principle is carried so far that even a suit for taxes cannot be maintained without the permission of the appointing court.² As to receivers appointed by federal courts, the rule has been abrogated by an Act of Congress which has been construed in a number of cases;³ and in some states statutes permit suits against receivers appointed by the state courts.⁴

§ 2012. **Effect of Judgment against Receiver.**—When the court permits a receiver to be sued at law, the judgment recovered

leave to sue a receiver, see *Farwell v. Great Western Tel. Co.*, 161 Ill. 522; 44 N. E. 891.

As to laches in prosecuting a claim against a receiver, see *Elmira, etc. Mill Co. v. Erie Ry. Co.*, 26 N. J. Eq. 284.

¹ *Barton v. Barbour*, 104 U. S. 126; *Fort Wayne, etc. R. R. Co. v. Mellett*, 92 Ind. 535. Cf. *Paige v. Smith*, 99 Mass. 395.

But see *Kinney v. Crocker*, 18 Wis. 74; *Lyman v. Central Vermont R. R. Co.*, 59 Vt. 167; 10 Atl. 346; *Camp v. Barney*, 4 Hun (N. Y.) 373.

² *Re Tyler*, 149 U. S. 164; 13 Sup. Ct. 785. Cf. *Central Trust Co. v. New York, etc. R. R. Co.*, 110 N. Y. 250; 18 N. E. 92; 1 L. R. A. 260; *Ledoux v. La Bee*, 83 Fed. 761.

But see *Stevens v. New York, etc. R. R. Co.*, 13 Blatchf. 104; *Central Trust Co. v. Wabash, etc. Ry. Co.*, 26 Fed. 11. The court which appointed the receiver should take care that all taxes are paid by the receiver, whether the state's claim is regularly filed or not. *Greeley v. Provident Savings Bank*, 98 Mo. 458; 11 S. W. 980.

³ *McNulta v. Lockridge*, 141 U. S. 327; 12 Sup. Ct. 11; *Texas, etc. Ry. Co. v. Cox*, 145 U. S. 593; 12 Sup. Ct. 905; *Texas, etc. Ry. Co. v. Johnson*, 151 U. S. 81; 14 Sup. Ct. 250; *Fullerton v. Fordyce*, 121 Mo. 1; 25 S. W. 585; 42 Am. St. Rep. 516; *St. Louis, etc. Ry. Co. v. Holbrook*, 73

Fed. 112; 19 C. C. A. 385; *Foreman v. Central Trust Co.*, 71 Fed. 776; 18 C. C. A. 321; *Central Trust Co. v. St. Louis, etc. Ry. Co.*, 41 Fed. 551; *Dillingham v. Hawk*, 60 Fed. 494; 9 C. C. A. 101; 23 L. R. A. 517; *Re Barnard*, 61 Fed. 531; *Irwin v. McKechnie*, 58 Minn. 145; 59 N. W. 987; 49 Am. St. Rep. 495; 26 L. R. A. 218; *Coster v. Parkersburg Branch R. R. Co.*, 131 Fed. 115; *Robinson v. Kirkwood*, 91 Ill. App. 54; *Farmers' L. & T. Co. v. Chicago, etc. R. Co.*, 118 Fed. 204; *Royal Trust Co. v. Washburn*, 113 Fed. 531 (suit to prevent receiver from carrying out order of court which appointed him not permitted); *Minot v. Mastin*, 95 Fed. 734; 37 C. C. A. 234; *Flippin v. Kimball*, 87 Fed. 258; 31 C. C. A. 282; *American Loan, etc. Co. v. Central Vt. R. R. Co.*, 84 Fed. 917; *J. I. Case Plow Works v. Finks*, 81 Fed. 529; 26 C. C. A. 46; *Jones v. Schlapback*, 81 Fed. 274; *Wheeler v. Smith*, 81 Fed. 319; *Buckhannon, etc. R. Co. v. Davis*, 135 Fed. 707; 68 C. C. A. 345 (suit to condemn property in receiver's hands for public use not permitted).

As to service of process on an agent of the defendant in a suit against a receiver, see *Central Trust Co. v. St. Louis, etc. Ry. Co.*, 40 Fed. 426; *State v. Port Royal, etc. Ry. Co.*, 84 Fed. 67.

⁴ *Meara's Admr. v. Holbrook*, 20 Oh. St. 137; 5 Am. Rep. 633.

against him is conclusive as against the bondholders and all other persons having claims to the assets out of which it must be paid.¹ But while this is true as to the existence and amount of the claim, the time and manner of its payment are to be controlled by the court appointing the receiver.²

§ 2013. **Defences available by Receiver.** — In any suit against the receiver growing out of his management of the business, he is entitled to all the defences which the company might have availed of, had it been defendant. Thus, the receiver of a railway company may plead a statute of limitations applicable by its terms only to actions against railroad corporations.³ The chancellor by whom the receiver was appointed, may, however, restrain him from setting up inequitable defences.⁴

§ 2014. **Grounds or Causes of Action against Receiver.** — Conversely, the receiver is subject to all the liabilities and burdens to which the company would have been subject.⁵ Thus, he is liable for any taxes which are levied upon corporations although the receiver cannot be said to be a corporation.⁶ So, the receiver of a railway company is subject to the liabilities and duties of a common carrier,⁷ and to any extraordinary liabilities imposed by statute on railroad companies.⁸ On the other hand, in Georgia

¹ *Turner v. Indianapolis, etc. Ry. Co.*, 8 Biss. 527; *St. Louis, etc. Ry. Co. v. Holbrook*, 73 Fed. 112; 19 C. C. A. 385.

² *Dillingham v. Hawk*, 60 Fed. 494; 9 C. C. A. 101; 23 L. R. A. 517. Cf. *Re Barnard*, 61 Fed. 531; *Irwin v. McKechnie*, 58 Minn. 145; 59 N. W. 987; 49 Am. St. Rep. 495; 26 L. R. A. 218.

³ *Bartlett v. Keim*, 50 N. J. Law 260; 13 Atl. 7.

⁴ *Lehigh Coal, etc. Co. v. Central R. R. Co.*, 42 N. J. Eq. 591; 8 Atl. 648.

⁵ *Klein v. Jewett*, 26 N. J. Eq. 474; *Winbourn's Case*, 30 Fed. 167; *Pope's Case*, 30 Fed. 169; *Robinson v. Kirkwood*, 91 Ill. App. 54.

Cf. *Northern Pac. R. Co. v. Am. Trading Co.*, 194 U. S. 439; 25 Sup. Ct. 84 (receivers liable on contract for transportation beyond the line of the company's railway); *Mem-*

phis, etc. R. R. Co. v. Glover, 29 So. 89; 78 Miss. 467 (liability of purchaser under agreement to pay any liability incurred by the receiver).

⁶ *Central Trust Co. v. New York, etc. R. R. Co.*, 110 N. Y. 250; 18 N. E. 92; 1 L. R. A. 260. Cf. *State v. Railroad Commissioners*, 41 N. J. Law 235.

⁷ *Newell v. Smith*, 49 Vt. 255; *Beers v. Wabash, etc. Ry. Co.*, 34 Fed. 244; *Handy v. Cleveland, etc. R. R. Co.*, 31 Fed. 689.

⁸ *Rouse v. Redinger*, 41 Pac. 433; 1 Kans. App. 355; *Peirce v. Van Dusen*, 78 Fed. 693.

But see *U. S. v. Harris*, 177 U. S. 305; 20 Sup. Ct. 609 (where the court held that the statute being penal, must be strictly construed).

A railway receiver must obey a state statute forbidding discrimination in respect to freight rates. *Cutting v. Florida Ry., etc. Co.*, 43 Fed.

it is held that a receiver of a railway company is not liable under a statute making railroad corporations liable to employees for negligence of fellow-servants;¹ but these decisions, contrary to the spirit at least of the generally accepted rules, are squarely opposed by cases in other states.² Where a person is injured in consequence of the want of repair of property in the receiver's hands, it has been held that the receiver is not exonerated because the defect may have existed before his appointment, even though sufficient time has not elapsed since his appointment to enable him to make the needful repairs.³ It has been said that receivers as officers of the court may not be liable for exemplary or punitive damages.⁴

§ 2015. **Effect of Discharge of Receiver.** — When a receiver has been discharged and the possession of the property in his hands re-delivered to the company, the exclusive jurisdiction of the court which appointed him is at an end; and any other court may accordingly subject the assets to liability for a claim which arose in the course of the receivership, whether sounding in contract or tort.⁵ Moreover, an order of court finally discharging a receiver has the effect of relieving him as representative

747; *Missouri Pac. Ry. Co. v. Texas* (Tex.), 67 S. W. 185; 28 Tex. Civ. App. 341.

¹ *Henderson v. Walker*, 55 Ga. 481; *Youngblood v. Comer*, 23 S. E. Rep. 509; 25 S. E. 838; 97 Ga. 152; *Central Trust Co. v. East Tennessee, etc. Ry. Co.*, 69 Fed. 353; 69 Fed. 357; *Baltimore Trust, etc. Co. v. Atlanta Traction Co.*, 69 Fed. 358.

In Texas it is held that a statute giving a remedy against the "proprietor, owner, charterer or hirer" of a railroad for death by negligence does not apply to an action against a receiver of a railway. *Turner v. Cross*, 83 Tex. 218; 18 S. W. 578; 15 L. R. A. 262; *Dillingham v. Scales*, 24 S. W. 975 (Tex.); *Yoakum v. Selph*, 83 Tex. 607; 19 S. W. 145; *Allen v. Dillingham*, 60 Fed. 176; *Burke v. Dillingham*, 60 Fed. 729; 9 C. C. A. 255; *Parker v. Dupree*

(Tex.), 67 S. W. 185; 28 Tex. Civ. App. 341.

² *Rouse v. Harry*, 55 Kans. 589; 40 Pac. 1007; *Peirce v. Van Dusen*, Rep. 509; 25 S. E. 838; 97 Ga. 152; 78 Fed. 693; *Hornsby v. Eddy*, 56 Fed. 461; 5 C. C. A. 560.

³ *Texas, etc. Ry. Co. v. Geiger*, 79 Tex. 13; 15 Sup. Ct. 214.

⁴ *Pope's Case*, 30 Fed. 169, 170.

⁵ *Mobile, etc. R. R. Co. v. Davis*, 62 Miss. 271.

Cf. *Texas, etc. Ry. Co. v. Johnson*, 151 U. S. 81; 14 Sup. Ct. 250; *Andrews v. Smith*, 5 Fed. 833. As to reservation of the exclusive right to adjudicate claims against the property notwithstanding the termination of the receivership, see *Wabash R. R. Co. v. Adelbert College*, 208 U. S. 38; 28 Sup. Ct. 182. Cf. *infra*, § 2031.

of the assets from any further liability.¹ Indeed, upon the discharge of the receiver and delivery of possession to the purchaser, the power of the court to adjudicate upon the validity or amount of claims against the mortgaged property, unless expressly reserved, comes to an end.²

§ 2016. **Interference with Receiver in Conduct of the Business as Contempt of Court.** — Inasmuch as receivers appointed on a bill to enforce the security of bondholders or debenture-holders are appointed in the exercise of the ordinary jurisdiction of a court of equity, to interfere with their possession or to place unlawful obstacles in the way of their conduct of the business is a contempt of court. The peculiar nature of the duties of such receivers gives rise to some new applications of this familiar principle. For instance, a libel on the business conducted by the receiver is a contempt of court; and hence, one who circulates a report that a receiver has been appointed for a partnership or corporation, omitting to state that the receiver has been authorized to continue the business, and who thus solicits custom from the customers of the firm or corporation, has been held to be in contempt.³ Upon the same principle, strikers, or members of a trade-union, who by force or intimidation interfere with the employees of a receiver are guilty of contempt of court.⁴

¹ *Farmers' L. & T. Co. v. Central R. R. of Iowa*, 7 Fed. 537; *Davis v. Duncan*, 19 Fed. 477; *Ryan v. Hays*, 62 Tex. 42; *Missouri, etc. Ry. Co. v. Wylie* (Tex.), 33 S. W. 771.

Cf. *Western, etc. R. Co. v. Penn Refining Co.*, 137 Fed. 343; 70 C. C. A. 23; *Ohio Coal Co. v. Whitcomb*, 123 Fed. 359.

² See *infra*, § 2066, § 2035, § 2031.

³ *Helmore v. Smith* (No. 2), 35 Ch. D. 449.

⁴ *Secor v. Toledo, etc. Ry. Co.*, 7 Biss. 513; *King v. Ohio, etc. Ry. Co.*, 7 Biss. 529; *Re Higgins*, 27 Fed. 443; *U. S. v. Kane*, 23 Fed. 748; *U. S. v. Debs*, 64 Fed. 724, 765-766; *Re Doolittle*, 23 Fed. 544; *Wabash R. Co.*, 24 Fed. 217.

The remedy of employees of a receiver who are dissatisfied with their wages is to apply to the court for an increase. *Ames v. Union Pac. R. Co.*, 4 Interst. Comm. Rep. 625. Cf. *Waterhouse v. Comer*, 55 Fed. 149; 19 L. R. A. 403; *Continental Trust Co. v. Toledo, etc. R. Co.*, 59 Fed. 514.

As to reduction of wages of a receiver's employees, see *U. S. Trust Co. v. Omaha, etc. Ry. Co.*, 63 Fed. 737; *Ames v. Union Pac. Ry. Co.*, 60 Fed. 674; *Continental Trust Co. v. Toledo, etc. R. Co.*, 59 Fed. 514; *Ames v. Union Pac. Ry. Co.*, 62 Fed. 7; *Thomas v. Cincinnati, etc. Ry. Co.*, 62 Fed. 17.

As to rescission of an order re-

§ 2017. **The Receiver's Compensation.** — In respect to their right to compensation or commissions, receivers appointed in suits to enforce the security of bonds or debentures do not differ from other receivers,¹ except that their greater responsibilities and more arduous duties naturally call in many cases for a more liberal allowance.

§ 2018. **Employment of Counsel by Receiver.** — Questions as to the receiver's right to employ counsel and as to their remuneration not infrequently arise.² But here again, the subject is not complicated by any principles peculiar to corporation law. The only difference is that receivers who are authorized to manage the business of a company naturally have more frequent occasion than other receivers to employ counsel. But the principles are in both cases the same. The reasonable fees of the receiver's solicitor employed with the sanction of the court are of course part of the receiver's costs of administration.³

§ 2019-§ 2020. *Strict Foreclosure.*

§ 2019. **When Strict Foreclosure may be had.** — The ultimate object of every suit for the enforcement of the security of bonds

ducing the wages of a receiver's employees, see *Thomas v. Cincinnati, etc. Ry. Co.*, 62 Fed. 669.

As to strikes and other labor troubles among employees of a receiver, see further *Booth v. Brown*, 62 Fed. 794; *Farmers' L. & T. Co. v. Northern Pac. R. R. Co.*, 60 Fed. 803; *Platt v. Philadelphia, etc. R. R. Co.*, 65 Fed. 660; *Beers v. Wabash, etc. Ry. Co.*, 34 Fed. 244; *Arthur v. Oakes*, 63 Fed. 310; 25 L. R. A. 414; 11 C. C. A. 209.

¹ Cf. *U. S. Trust Co. v. New York, etc. Ry. Co.*, 101 N. Y. 478; 5 N. E. 316; *Cowdrey v. Railroad Co.*, 1 Woods 331; *Cake v. Woodbury*, 3 App. Cas. (D. C.) 60; *Central Trust Co. v. Cincinnati, etc. Ry. Co.*, 58 Fed. 500; *Boston, etc. Trust Co. v. Chamberlain*, 66 Fed. 847; 14 C. C. A. 363; *Central Trust Co. v. Wabash, etc. Ry. Co.*, 32 Fed. 187; *Easton v. Houston, etc. Ry. Co.*, 40 Fed. 189;

Montgomery v. Petersburg, etc. Ins. Co., 70 Fed. 746; 17 C. C. A. 360.

As to extra compensation in addition to that provided by the order of appointment, see *Farmers' L. & T. Co. v. Central R. R. of Iowa*, 8 Fed. 60.

² See *Cowdrey v. Railroad Co.*, 1 Woods 331; *Cake v. Woodbury*, 3 App. Cas. (D. C.) 60; *Blair v. St. Louis, etc. R. Co.*, 20 Fed. 351; *Boston, etc. Trust Co. v. Chamberlain*, 66 Fed. 847; 14 C. C. A. 363; *Easton v. Houston, etc. Ry. Co.*, 40 Fed. 189; *Montgomery v. Petersburg, etc. Ins. Co.*, 70 Fed. 746; 17 C. C. A. 360.

The plaintiff's attorney should not be employed as attorney for the receiver. *Blair v. St. Louis, etc. R. Co.*, 20 Fed. 348. But cf. *W. C. Horne & Sons* (1906), 1 Ch. 271.

³ *W. C. Horne & Sons* (1906), 1 Ch. 271.

or debentures is either strict foreclosure or sale. The latter relief is much more frequently asked for; but if the bondholders or debenture-holders prefer, they may, at least in England, have a strict foreclosure even when the security is a mere floating charge and covers uncalled capital.¹ In England it is held that strict foreclosure cannot be had unless all the debenture-holders are parties to the case, actually, and not merely by representation by the suit having been brought by one of their number on behalf of all.² This is true because the effect of a strict foreclosure is to make all the bondholders tenants in common, and the court has no right to thrust property on any man without his consent. In America this objection has, perhaps, never been made the basis of a decision although in at least one case it seems to have been in the mind of the court.³

§ 2020. **Consequences of Strict Foreclosure.** — Strict foreclosure necessarily makes the bondholders tenants in common, in equity if not at law, of the property covered by the charge; and if some of the bondholders organize a new corporation to take over their interests, the new company becomes a cotenant with the other bondholders, and as such bound to account to them for their share of the earnings of the property which it has received.⁴ The Supreme Court of Vermont, in a careful and learned opinion, has held that upon foreclosure, the title, in trust for the bondholders, vests in the trustee, who is then clothed with the active duty of managing it and who for that object may make reasonable leases, etc.⁵

§ 2021–§ 2038. SALE IN LIEU OF STRICT FORECLOSURE.

§ 2021–§ 2022. *When Sale may be had.*

§ 2021. **In general.** — A sale of the property covered by the charge is much the more usual and convenient relief.⁶ Although

¹ *Sadler v. Worley* (1894), 2 Ch. *Railroad Co.*, 99 U. S. 334; *Sanxey* 170; 1 *Lindley on Companies*, 6th ed., 335. Cf. *Langdon v. Vermont, etc. R. R. Co.*, 54 Vt. 593. ⁴ *Brooks v. Vermont Central R. R. Co.*, 22 Fed. 211.

But see *Shepard v. Richardson*, 145 Mass. 32; 11 N. E. 738.

² *Continental Oxygen Co.* (1897), 1 Ch. 511.

³ *Ketchum v. Duncan*, 96 U. S. 659, 671–672. Cf. *Sage v. Central*

⁵ *Sturges v. Knapp*, 31 Vt. 1.

⁶ As to the power to decree a sale of a railway or similar semi-public business, see *supra*, § 1996.

the bill prays specifically a strict foreclosure, yet under the prayer for general relief a decree for a sale may properly pass.¹ A sale of the corpus may be had for default in the payment of interest although the principal be not yet due.² To what extent the proceeds of such a sale are applicable to payment of the principal has been already considered.³ Indeed, a sale may be decreed, if necessary for the enforcement of the security, even though interest alone is in arrears and though the bonds or mortgage confer no power of sale in case of non-payment of interest.⁴ If the property covered by the charge can be sold in parcels without sacrifice, the court may decree a sale of so much only as will pay the overdue interest.⁵

§ 2022. **Discretion of Court as to Time of Sale.** — The court may in its discretion defer the sale for a reasonable time⁶ until a period of financial depression shall have passed away;⁷ or until certain subsidies shall have been earned by the completion of the road by the receiver,⁸ or until the termination of litigation the pendency of which would depreciate the value of the mortgaged property.⁹ But on the other hand, it should not postpone a sale because the earnings during the receivership may have been such as to justify the expectation that if the receiver's

¹ *Sage v. Central R. R. Co.*, 99 U. S. 334.

² *Howell v. Western R. R. Co.*, 94 U. S. 463; *Ohio Central R. R. Co. v. Central Trust Co.*, 133 U. S. 83; 10 Sup. Ct. 235; *Taber v. Cincinnati, etc. Ry. Co.*, 15 Ind. 459; 466-467, *McFadden v. Mays Landing, etc. Co.*, 49 N. J. Eq. 176; 22 Atl. 932; *Goodman v. Cincinnati, etc. R. R. Co.*, 2 Disn. (Oh.) 176; *Farmers' L. & T. Co. v. Chicago, etc. Ry. Co.*, 27 Fed. 146. Cf. *Chicago, etc. R. R. v. Fosdick*, 106 U. S. 47, 75; 1 Sup. Ct. 10; *Bardstown, etc. R. R. Co. v. Metcalfe*, 4 Metc. 199, 211-212; 81 Am. Dec. 541.

But see *Randolph v. Middleton*, 26 N. J. Fq. 543. For a case where the principal became due pending a suit for sale on account of default in payment of interest, see *Seattle, etc. Ry. Co. v. Union Trust Co.*, 79 Fed. 179; 24 C. C. A. 512.

³ *Supra*, § 1780, § 1804.

⁴ *McLane v. Placerville, etc. R. R. Co.*, 66 Cal. 606; 6 Pac. 748. Cf. *Forrest's Ex'rs v. Luddington*, 68 Ala. 1, 15-16.

⁵ *Pennsylvania R. R. Co. v. Allegheny, etc. R. R. Co.*, 48 Fed. 139.

⁶ See *supra*, § 1997. See also *American Loan, etc. Co. v. Union Depot Co.*, 80 Fed. 36; *U. S., etc. Trust Co. v. Young (Tex.)*, 101 S. W. 1045 (where the order of postponement was passed after the lapse of the term of court at which the decree for an immediate sale had been signed).

⁷ *Atlantic, etc. R. R. Case*, 4 Hughes 125; s. c. *sub nom.*, *Duncan v. Atlantic, etc. R. R. Co.*, 88 Fed. 840.

⁸ *Bibber White Co. v. White River, etc. Co.*, 110 Fed. 473.

⁹ *U. S., etc. Trust Co. v. Young (Tex.)*, 101 S. W. 1045.

management should be continued all arrearages due upon the bonds could be paid off.¹

§ 2023-§ 2027. *Of the Right of Redemption.*

§ 2023. **Necessity for allowing Time to redeem.** — The decree for sale should afford full opportunity to the corporation or those interested in the corporation² to redeem prior to the sale by paying off the arrears of the secured indebtedness.³ The length of time allowed for redemption rests entirely within the discretion of the court, provided a reasonable time is given. Four months has been held to be not an unreasonably short time,⁴ and in one case even so short a period as ten days was held sufficient.⁵

§ 2024. **Necessity for ascertaining before Sale the Amount due on the Mortgage.** — In order to preserve inviolate the right of redemption, the amount due upon the mortgage or charge which is being enforced should before the sale be accurately ascertained;⁶ and if the amount declared to be due is excessive, the error, obstructing as it does the right of redemption, will permeate and vitiate the subsequent proceedings, so as to justify a reversal of the order confirming a sale,⁷ although in case of such

¹ *Atlantic, etc. R. R. Case*, 4 Hughes 125; s. c. *sub nom.*, *Duncan v. Atlantic, etc. R. R. Co.*, 88 Fed. 840.

² As to the right of subsequent mortgagees to redeem, see *infra*, § 2027.

As to the right of holders of bonds of the same series which is sought to be enforced to redeem by paying off all bonds of that series whose holders desire a foreclosure, see *Tillinghast v. Troy, etc. R. R. Co.*, 48 Hun (N. Y.) 420.

³ Cf. *Jackson, etc. Co. v. Burlington, etc. R. Co.*, 29 Fed. 474; *Bound v. South Carolina, etc. Ry. Co.*, 58 Fed. 473; 7 C. C. A. 322.

⁴ *Columbia, etc. Trust Co. v. Kentucky Union Ry. Co.*, 60 Fed. 794; 9 C. C. A. 264.

⁵ *Wells v. Northern Trust Co.*, 195 Ill. 288; 63 N. E. 136.

⁶ Cf. *State v. Brown*, 64 Md. 199; 1 Atl. 54; 6 Atl. 172. For outline of

form of decree, see *Howell v. Western R. R. Co.*, 94 U. S. 463, 466-467.

But cf. *Dickerman v. Northern Trust Co.*, 176 U. S. 181, 196-206; 20 Sup. Ct. 311 (holding that the liability of bonds to an off-set or abatement by reason of a liability of certain bondholders to the company for fraudulent profits made by them as promoters need not be determined before sale); *First Nat. Bank v. William R. Trigg Co. (Va.)*, 56 S. E. 158; *Farmers' L. & T. Co. v. Toledo, etc. Ry. Co.*, 67 Fed. 49, 59-60 (stated *supra*, § 1889, where over-issued bonds, being good against the corporation, were treated as outstanding for purposes of foreclosure).

As to a case where the property is subject to two mortgages, see *Racine, etc. R. R. Co. v. Farmers' L. & T. Co.*, 49 Ill. 331, 353; 95 Am. Dec. 595.

⁷ *Chicago, etc. R. R. Co. v. Fosdick*, 106 U. S. 47; 1 Sup. Ct. 10.

reversal the rights of a *bona fide* purchaser under the decree should be protected.¹ The approved practice is not to attempt to ascertain by the decree itself the amount due upon outstanding bonds or coupons, but to refer this matter to a master, the decree to stand for the benefit of such bonds only as appear to be entitled to the benefit of it.²

The sale may, moreover, be made subject to such claims as the court upon future consideration may determine to have priority over the mortgage bonds;³ or where there are conflicting claims to priority by holders of two different series of bonds, secured by two separate mortgages, the court may, with the assent of the corporation and all persons interested, except certain minority bondholders, decree a sale before deciding the questions of priority.⁴ Nor is it any objection to a decree for sale by way of foreclosure that it leaves uncertain the amount of costs, counsel fees, etc., necessary to be paid in order to redeem;⁵ for it is said any person interested may at any time move for a determination of whatever in such matters has been left at large.

The ownership of the bonds, as distinguished from the amount due thereon, need not be determined before the sale.⁶ Hence,

¹ *Chicago, etc. R. R. Co. v. Fosdick*, 106 U. S. 47, 85; 1 Sup. Ct. 10 (semble); *Grape Creek Coal Co. v. Farmers' L. & T. Co.*, 63 Fed. 891; 12 C. C. A. 350. Cf. *Graham v. Boston, etc. R. R. Co.*, 118 U. S. 161; 6 Sup. Ct. 1009 (where it was held that the invalidity of some of the bonds secured by a mortgage would not support a bill to set aside a foreclosure of the mortgage).

² *Galveston R. R. Co. v. Cowdrey*, 11 Wall. 459, 477. Cf. *Mason v. York & Cumberland R. R. Co.*, 52 Me. 82; *Dickerman v. Northern Trust Co.*, 176 U. S. 181, 194-195; 20 Sup. Ct. 311.

³ *Sage v. Central R. R. Co.*, 99 U. S. 334, 345-346 (headnote inadequate). Cf. *Compton v. Jesup*, 167 U. S. 1; 17 Sup. Ct. 795; *Campbell v. Texas, etc. R. R. Co.*, 2 Woods Trust Co. v. *International Trust Co. v. Decker Bros.*, 152 Fed. 78 (where the

discretion of the court was held to have been abused).

But see *Sutherland v. Lake Superior, etc. Co.*, 23 Fed. Cas. 459, No. 13, 643.

⁴ *First Nat. Bank v. Shedd*, 121 U. S. 74; 7 Sup. Ct. 807.

Cf. *Campbell v. Texas, etc. R. R. Co.*, 2 Woods 263; *Pennsylvania R. R. Co. v. Allegheny Valley R. R. Co.*, 42 Fed. 82.

⁵ *Grape Creek Coal Co. v. Farmers' L. & T. Co.*, 63 Fed. 891; 12 C. C. A. 350; *Alabama, etc. Mfg. Co. v. Robinson*, 72 Fed. 708; 19 C. C. A. 152.

Cf. *Bound v. South Carolina Ry. Co.*, 58 Fed. 473, 479; 7 C. C. A. 322.

⁶ *Washington, etc. R. R. Co. v. Cazenove*, 83 Va. 744; 3 S. E. 433; *Sioux City, etc. Ry. Co. v. Manhattan Trust Co.*, 92 Fed. 428; 34 C. C. A. 431 (allegations in answer as to ownership of certain bonds stricken

the bonds need not be produced before the master before a sale is decreed.¹ Moreover, where the bonds are issued as collateral security for a debt of the company, it is not necessary to ascertain the amount of that debt, which would be material in order to enable the company to redeem the bonds from the pledge but has no bearing on the amount necessary to redeem its property from the mortgage.²

§ 2025. **Money in Receiver's Hands to be applied in Reduction of the Amount payable in order to redeem.** — Moreover, any person who may wish to redeem is entitled to have any moneys in the receiver's hands applied in reduction of the mortgage debt, so as to diminish the outlay necessary to the exercise of the right of redemption. Hence, the decree should give liberty to the company at any time before foreclosure absolute to apply to the judge for payment and transfer to the security-holders, on account of the sum due them, of any money or funds in court or in the receiver's hands.³

§ 2026. **Consequences of Exercise of Right of Redemption.** — The consequence of the payment in due time by the company, or by anyone on its behalf, of the amount necessary to redeem is that the foreclosure suit terminates, unless the company should commit another default. Upon such payment the receiver must, of course, be discharged and possession restored to the company.⁴

out as immaterial until the distribution of the proceeds of sale comes up for consideration). ³ *Cumming v. Metcalfe's London Hydro*, 2 Manson 418.

Cf. *Western Supply, etc. Co. v. U. S. etc. Trust Co. (Tex.)*, 92 S. W. 986; *Knickerbocker Trust Co. v. Oneonta, etc. Ry. Co.*, 101 N. Y. Supp. 241 (quære, whether the learned court did not err in confusing a question whether some of the bonds were owned by the company itself with the question of ownership of bonds proved to be outstanding). Cf. *Racine, etc. R. R. Co. v. Farmers' L. & T. Co.*, 49 Ill. 331, 353; 95 Am. Dec. 595 (where the court decreed that before sale an account should be taken of certain sums owing to the company and applicable to payment of the bonds).

⁴ *Milwaukee, etc. R. R. Co. v. Soutter*, 2 Wall. 510. Cf. *Union Trust Co. v. Union, etc. Ry. Co.*, 26 Fed. 485; *Farmers' L. & T. Co. v. Chicago, etc. Ry. Co.*, 27 Fed. 146.

But in a case where the trustees of the mortgage had taken possession after default by the company, the court held that the company could not demand a redelivery of possession upon payment of the amount then due, but must also give security for the amount there-

Where the trustees of the mortgage have taken possession, a formal bill to redeem may be necessary.¹

§ 2027. **Effect of Sale on Right of Redemption.** — The sale of course cuts off or forecloses the right of redemption by the corporation. Sometimes the sale is made, however, under such circumstances that while the company's right to redeem is cut off, the right of some junior encumbrancer is preserved. For instance, if junior encumbrancers, such as holders of second-mortgage bonds or their trustees, are not parties to the suit to enforce the first mortgage, the second-mortgage bondholders would still be entitled to redeem. If, however, the second mortgagee is a party to the foreclosure suit, his right of redemption will be gone, although the decree of sale does not expressly provide that the right of the junior encumbrancers shall be foreclosed.²

In some states statutes confer upon ordinary mortgagees the right to redeem within some limited time *after* the foreclosure sale; but this right is wholly statutory, and, being strictly construed, is held to have no application to a sale of a railroad under proceedings to enforce the security of an issue of bonds,³ or indeed to sales under mortgages to secure bonds or debentures executed by other than railway companies.⁴

§ 2028-§ 2033. *Terms of Sale.*

§ 2028. **In general.** — The terms of the sale, as in other cases of judicial sales, rest almost entirely within the discretion of the court.⁵ Thus, the court may authorize payment by the purchaser in the company's bonds of the issue being enforced in the suit,

after to become due: *Wood v. Water Co.*, 78 Fed. 881; *Columbia, Goodwin*, 49 Me. 260; 77 Am. Dec. 259. *Sed quære.* *etc. Trust Co. v. Kentucky Union Ry. Co.*, 60 Fed. 794; 9 C. C. A. 264.

¹ See *Kennebec, etc. R. R. Co. v. Portland, etc. R. R. Co.*, 54 Me. 173.

² *Simmons v. Burlington, etc. Ry. Co.*, 159 U. S. 278; 16 Sup. Ct. 1 (reversing *Simmons v. Taylor*, 23 Fed. 849; 38 Fed. 682).

³ *Peoria, etc. R. R. Co. v. Thompson*, 103 Ill. 187, 207-210; *Hammock v. Loan & Trust Co.*, 105 U. S. 77; *Farmers' L. & T. Co. v. Iowa*

⁴ *Pacific Northwest Packing Co. v. Allen*, 116 Fed. 312; 54 C. C. A. 648.

⁵ Cf. *Turner v. Indianapolis, etc. Ry. Co.*, 8 Biss. 380, where the court required \$100,000 to be paid in cash at the time of sale. See also

Farmers' L. & T. Co. v. Oregon, etc. R. R. Co., 40 Pac. 1089; 28 Oreg. 44; *Southwestern, etc. Ry. Co. v. Hays*, 38 S. W. Rep. 665; 63 Ark. 355.

although in that way a purchase by persons holding a small number of the bonds is rendered more difficult than a purchase by persons holding a larger number.¹ Where the decree authorizes payment in bonds instead of cash, it is not necessary to fix the value at which the bonds shall be received prior to the sale.² Where the decree provides that payment *may* be made in bonds at a valuation to be determined by the court after the sale, the court is not precluded from requiring the purchaser to pay some part or all of the price in cash instead of bonds.³ The privilege of paying in bonds if extended to any of the bondholders, should be extended to all on the same terms.⁴ The decree may provide that the trustee for the bondholders, if under a provision in the deed of trust he shall bid the property in, shall be excused from the payment of a cash deposit required of other purchasers.⁵ But in the absence of any power in the deed of trust conferred on the trustee the court must not direct him to buy the property in for the face value of the bonds, against the objection of any of the bondholders.⁶

One of the most important questions relating to the terms of sale is whether the mortgaged property shall be sold as an entirety or piecemeal;⁷ and a clear abuse of discretion on this

¹ *Ketchum v. Duncan*, 96 U. S. 659, 672-674 (headnote inadequate); *Farmers' L. & T. Co. v. Green Bay, etc. R. R. Co.*, 10 Biss. 203; 6 Fed. 100; *Kropholder v. St. Paul, etc. Ry. Co.*, 2 Fed. 302; *Real Estate Trust Co. v. Perry County R. R. Co.*, 213 Pa. 57; 62 Atl. 25 (where an objection to this provision of the decree was held to be too late after confirmation of the sale).

Cf. *American Waterworks Co. v. Farmers' L. & T. Co.*, 73 Fed. 956; 20 C. C. A. 133; *Toledo, etc. R. R. Co. v. Continental Trust Co.*, 95 Fed. 497; 36 C. C. A. 155 (where part of the purchase price was made payable in preferred stock, enough being realized in cash to pay off the bonds and the property being taken subject to a lien in favor of other creditors).

² *Farmers' L. & T. Co. v. Green Bay, etc. R. R. Co.*, 10 Biss. 203; 6 Fed. 100.

³ *Farmers' L. & T. Co. v. Green Bay, etc. R. R. Co.*, 6 Fed. 100, 106-107; 10 Biss. 203.

Cf. *Central Trust Co. v. Cincinnati, etc. Ry. Co.*, 58 Fed. 500, where the court refused to increase the amount which by the terms of the sale was payable in cash instead of bonds.

⁴ *American Waterworks Co. v. Farmers' L. & T. Co.*, 73 Fed. 956; 20 C. C. A. 133.

⁵ *Sage v. Central R. R. Co.*, 99 U. S. 334.

⁶ *Sanxey v. Iowa City Glass Co.*, 63 Iowa 707; 17 N. W. 429.

⁷ Cf. *Central Trust Co. v. U. S. Rolling Stock Co.*, 56 Fed. 5; *Harris v. Youngstown Bridge Co.*, 90 Fed. 322; 33 C. C. A. 69; 95 Fed. 355; 35 C. C. A. 341; *Wheeling, etc. Ry. Co. v. Reymann Brewing Co.*, 90 Fed. 189; 32 C. C. A. 571 (where part of the property was subject to a prior vendor's lien)

important point will be corrected on appeal. The property of a public service company should not be sold separate from its franchise.¹

The terms of sale may be altered in the discretion of the court at any time before the sale has taken place, even after original decree for sale has become enrolled.²

§ 2029. **Fixing Upset Price.** — The court should usually fix an upset price sufficient to cover costs, receiver's certificates and other claims having priority over the bonds.³

§ 2030. **Sale in Conjunction with Property covered by other Mortgages.** — Where two or more mortgages, each covering one of several connecting lines of railroad, are being foreclosed simultaneously, the court may order that the whole railway system shall be sold as an entirety.⁴ And where a railway mortgage is a first lien upon some of the company's property and a second lien upon the rest, the court may decree a sale of the whole line leaving the respective priorities to be adjusted upon a distribution of the proceeds.⁵

§ 2031. **Sale subject to certain Claims if ultimately established.** — We have seen above that a sale may be ordered subject to certain claims if they shall be afterwards determined to be valid;⁶ or to claims of unascertained amount.⁷ In such cases, the court retains jurisdiction to pass upon the claims and to enforce payment, although the receivership has terminated;⁸ and indeed

¹ *Connor v. Tennessee Central Ry. Co.*, 109 Fed. 931; 48 C. C. A. 730; 54 L. R. A. 687. Fed. 438; *Low v. Blackford*, 87 Fed. 392; 31 C. C. A. 15.

But see *Wabash, etc. Ry. Co. v. Central Trust Co.*, 22 Fed. 138. ⁵ *Ludlow v. Clinton Lines R. R. Co.*, 1 Flip. 25.

² *Royal Trust Co. v. Washburn*, 113 Fed. 531. But see *Olyphant v. St. Louis Ore, etc. Co.*, 23 Fed. 465.

³ *Blair v. St. Louis, etc. R. Co.*, 25 Fed. 232. Cf. *Central Trust Co. v. Washington County R. R. Co.*, 124 Fed. 813. ⁶ *Supra*, § 2024. See also *infra*, § 2035. As to the effect of such a provision, see further *Compton v. Jesup*, 167 U. S. 1; 17 Sup. Ct. 795.

⁴ *Union Trust Co. v. Illinois Midland Ry. Co.*, 117 U. S. 434, 474-475; 6 Sup. Ct. 809; *Gibert v. Washington City, etc. R. R. Co.*, 33 Gratt. (Va.) 586, 609-613. Cf. *Meyer v. Johnston*, 53 Ala. 237, 352; *Carey v. Houston, etc. Ry. Co.*, 45 123 Fed. 359. Cf. *infra*, § 2035, § 2066. ⁷ *Turner v. Indianapolis, etc. Ry. Co.*, 8 Biss. 380. Cf. *Farmers' L. & T. Co. v. Oregon, etc. R. R. Co.*, 40 Pac. 1089; 28 Oreg. 44.

⁸ *Ohio Coal Co. v. Whitcomb*, 123 Fed. 359. Cf. *infra*, § 2035, § 2066.

the jurisdiction so retained may be exclusive of the jurisdiction of any other court.¹

§ 2032. **Restrictions statutory or conventional upon the Discretion of the Court as to Terms of Sale.** — The courts are somewhat restive under any restraints upon their discretion as to the terms of sale. If the restraints are imposed by the legislature, the statute will be confined by construction within the narrowest possible limits.² Thus, a statute prescribing, virtually, a sale of mortgaged real estate in parcels has been held to have no application to sales in lieu of foreclosure of railway mortgages.³ If the restraint is sought to be imposed by the parties by a provision in the bonds or deed of trust, the courts are apt — probably too apt — to hold that the clause is void as ousting the courts of their jurisdiction. Where a railway company issued three sets of bonds, each secured by a first lien on one of the three divisions into which the road was divided and a second lien on the other two, a provision that in case of default the trustee should offer the road for sale first as an entirety and then, if no acceptable bid were obtained, in separate divisions has been held not to prevent the court from decreeing a sale as an entirety absolutely and in the first instance.⁴ In general, stipulations in the bonds or in the mortgage as to the terms of a sale by the trustee under a power do not bind the court in deciding upon the terms of a sale under decree by way of foreclosure.⁵

§ 2033. **What passes by the Sale.** — Precisely what property will pass by the sale must be determined in each case by the terms of the decree and of the sale. Of course ordinarily the sale should not include property or rights not covered by the mortgage. The meaning of general words, such as "all the company's property," its "franchises," its "undertaking," etc., has already been considered in connection with the question what passes by the mortgage, and the same rules and principles govern the question what passes by similar language in a decree of sale. It has, however, been held that greater particularity of description

¹ *Wabash Railroad Co. v. Albert College*, 208 U. S. 38; 28 Sup. Ct. 182.

² See *Pacific Northwest Packing Co. v. Allen*, 116 Fed. 312; 54 C. C. A. 648.

³ *Hammock v. Loan & Trust Co.*, 105 U. S. 77.

⁴ *Low v. Blackford*, 87 Fed. 392; 31 C. C. A. 15.

⁵ *Farmers' L. & T. Co. v. Green Bay, etc. R. R. Co.*, 10 Biss. 203; 6 Fed. 100. Cf. *supra*, § 1978.

is necessary in a notice of sale than in the mortgage, in order that intending purchasers may know accurately what is being sold and may adjust the amount of their bids accordingly.¹ A sale of all the company's property and franchises will not entitle the purchaser to money earned by the receiver by carrying on the business before the sale.² But where the franchises and property of a railway company are sold at a foreclosure sale, the purchaser acquires title to rolling stock bought by the receiver in order to maintain the business.³ Ordinarily, the purchaser acquires the right to all net profits earned by the receiver after the sale by continuing to carry on the business.⁴ But where the sale is made subject to a prior mortgage, and before possession is delivered by the receiver to the purchaser, a suit to foreclose the prior mortgage is instituted and the same person appointed as receiver to represent the bondholders under that mortgage, all profits subsequently earned belong not to the purchaser but to the holders of the bonds secured by the prior mortgage.⁵

§ 2034. Rights of Parties in Interval between Making of Sale and its final Ratification by the Court. — During the time intervening between the date of the sale and the time of its final confirmation by the court, the receiver continues in possession of the property with undiminished powers.⁶ His expenses continue to be a first lien on the property; and, generally, his status is unaffected by the sale. For instance, he does not become the

¹ *Milwaukee & Minnesota Ry. Co. v. Milwaukee & Western R. R. Co.*, 20 Wisc. 174; 88 Am. Dec. 740.

But the purchaser may be required to assume the payment of the receiver's expenses although the amount thereof may not have been judicially ascertained prior to the sale: the uncertainty is not deemed sufficient to deter intending purchasers from bidding. *Bound v. South Carolina Ry. Co.*, 58 Fed. 473, 479; 7 C. C. A. 322. Cf. *supra*, § 2024, § 2031, and *infra*, § 2035.

² *Strang v. Montgomery, etc. R. R.*

Co., 3 Woods 613; *Washington Irrigation Co. v. California Safe Deposit Co.*, 115 Fed. 20; 52 C. C. A. 614.

³ *Strang v. Montgomery, etc. R. R. Co.*, 3 Woods 613.

⁴ Cf. *Boyle v. Farmers' L. & T. Co.*, 88 Fed. 930; 32 C. C. A. 142 (where the purchaser was held to have forfeited his rights by delay in compliance with his bid).

⁵ Cf. *Downs v. Farmers' L. & T. Co.*, 79 Fed. 215; 24 C. C. A. 500.

⁶ See *infra*, § 2066.

agent of the purchaser, and hence the purchaser is not liable for torts committed by the receiver's servants during that interval,¹ or even during a period of a few days intervening between the final confirmation of the sale and the delivery of possession to the purchaser.²

§ 2035. **Liability of Purchaser for Liabilities of the Old Company or of the Receiver.** — The purchasers of the company's property at a sale made by way of enforcing the security of bondholders take as any other assignees. That all the company's property is sold does not make the purchasers the successors of the mortgagor company so as to render them liable for its contractual obligations³ or for its torts.⁴ If the law were otherwise, the purchasers would take subject to the obligation of the mortgage bonds, and nothing would be accomplished by the sale. Of course as assignees, the purchasers are bound by any contracts that run with the property sold, or constitute a lien or charge thereon, and that antedate the mortgage.⁵ So they may be sub-

¹ *Metz v. Buffalo, etc. R. R. Co.*, 58 N. Y. 61; 17 Am. Rep. 201.

² *Fidelity Ins., etc. Co. v. Norfolk*, N. Y. App. Div. 352, affirmed short in 183 N. Y. 557.

³ *City of Menasha v. Milwaukee, etc. R. R. Co.*, 52 Wisc. 414; 9 N. W. 396; *Lake Erie, etc. Ry. Co. v. Griffin*, 92 Ind. 487; *Stewart's Appeal*, 72 Pa. St. 291; *Smith v. Chicago, etc. Ry. Co.*, 18 Wisc. 17; *Hunter v. Burlington, etc. Ry. Co.*, 76 Iowa 490; 41 N. W. 305; *Cook v. Detroit, etc. Ry. Co.*, 43 Mich. 349; 5 N. W. 390; *Vilas v. Milwaukee, etc. Ry. Co.*, 17 Wisc. 497; *Sherwood v. Atlantic, etc. R. R. Co.*, 26 S. E. Rep. 943; 94 Va. 291; *Pennsylvania Transportation Company's Appeal*, 101 Pa. St. 576; *Keeler v. Atchison, etc. Ry. Co.*, 92 Fed. 545; 34 C. C. A. 523 (where the reorganized company was formed under a statute which provided that the reorganization should "in nowise affect any liability of the old company"); *Venner v. Farmers' L. & T. Co.*, 90 Fed. 348; 33 C. C. A. 95; *Lincoln Tp. v. Kansas City, etc. R. Co. (Nebr.)*, 108 N. W. 140.

⁴ *Hammond v. Port Royal, etc. Ry. Co.*, 15 S. Car. 10; *Campbell v. Pittsburgh, etc. Ry. Co.*, 137 Pa. St. 574; 20 Atl. 949.

⁵ *Drury v. Midland R. R. Co.*, 127 Mass. 571; *Varner v. St. Louis, etc. R. R. Co.*, 55 Iowa 677; 8 N. W. 634; *St. Joseph Union Depot Co. v. Chicago, etc. Ry. Co.*, 131 Mo. 291; 31 S. W. 908; *Loomis v. Davenport, etc. R. R. Co.*, 3 McCrary 489; *South Carolina R. R. Co. v. Wilmington, etc. R. R. Co.*, 7 S. Car. 410; *Mayor, etc. of Boonton v. Boonton Water Co. (N. J.)*, 61 Atl. 390 (contract by water company with municipality binds purchaser of waterworks at foreclosure sale); *St. Joseph Union Depot Co. v. Chicago, etc. Ry. Co.*, 89 Fed. 648; 32 C. C. A. 284 (rental of property passing under the mort-

Cf. *Chicago, etc. R. R. Co. v. Towle*,

ject to statutory obligations of the mortgagor company if the statute imposing the obligation indicates an intent that they should be.¹ Sometimes the purchaser takes expressly subject to certain claims to which he would not otherwise be liable.² Moreover, for some claims that cannot properly be denominated liens but which the person who takes the benefit of the property sold ought in fairness to pay, the purchaser will incur, according to some courts, an equitable obligation.³ Even where the purchasing company expressly assumes certain unsecured claims of the old company, such claims become merely unsecured claims against the new company and as such entitled to no preference

gage by virtue of the after-acquired property clause).

Cf. *Manhattan Trust Co. v. Sioux City, etc. R. R. Co.*, 81 Fed. 50 (where the contract could not bind a purchaser because it was not recorded); *Westinghouse Electric, etc. Co. v. New Paltz*, 32 N. Y. Misc. 132; 65 N. Y. Supp. 644 (similar point).

As to whether the terms of sale are such as between the purchaser and the bondholders to charge preferred claims on the proceeds of sale rather than on the property in the hands of the purchaser, see *First Nat. Bank v. Ewing*, 103 Fed. 168, 188-191; 43 C. C. A. 150 (claims for taxes with penalty and interest).

¹ *Norfolk, etc. R. R. Co. v. Pendleton*, 86 Va. 1004; 11 S. E. 1062; *New York, etc. R. R. Co. v. State*, 50 N. J. Law 303; 13 Atl. 1; *Mobile, etc. Ry. Co. v. Steiner*, 61 Ala. 559; *State v. Central Iowa Ry. Co.*, 71 Iowa 410; 32 N. W. 409; 60 Am. Rep. 806.

Cf. *Gage v. Pontiac, etc. R. R. Co.*, 105 Mich. 335; 63 N. W. 318; *Baltimore Trust, etc. Co. v. Hofstetter*, 85 Fed. 75; 29 C. C. A. 35 (held that statute giving claims for personal injuries, etc., priority over previously issued bonds does not create a lien, and a purchaser at the foreclosure sale does not take subject thereto).

² *Wabash R. R. Co. v. Stewart*, 41 Ill. App. 640; *Missouri, etc. Ry. Co. v. Lacy*, 35 S. W. Rep. 505; 13 Tex.

Civ. App. 391; *Wood v. Dubuque, etc. R. R. Co.*, 28 Fed. 910; *Farmers' L. & T. Co. v. Central R. R. of Iowa*, 7 Fed. 537; *Anderson v. Conduct*, 93 Fed. 349; 35 C. C. A. 335; 94 Fed. 716; 36 C. C. A. 437; *Central Trust Co. v. Georgia Pac. Ry. Co.*, 87 Fed. 288; 30 C. C. A. 648; *Continental Trust Co. v. American Surety Co.*, 80 Fed. 180; 25 C. C. A. 364.

Cf. *Atchison, etc. Ry. Co. v. Osborn*, 148 Fed. 606; 78 C. C. A. 378 (holding a claim for damages against old company not equitably entitled to a preference over the old bonds and therefore not such a claim as the purchaser assumed), and see also supra, § 2031.

As to the effect of payment by the purchaser of a sum of money into court in transferring the lien from the property to the fund, see *St. Louis, etc. Ry. Co. v. Jackson*, 95 Fed. 560; 37 C. C. A. 165; *Anderson v. Conduct*, 93 Fed. 349; 35 C. C. A. 335; 94 Fed. 716; 36 C. C. A. 437; *Morgan's, etc. Co. v. Moran*, 91 Fed. 22; 33 C. C. A. 313.

³ *Houston, etc. R. R. Co. v. Crawford*, 31 S. W. Rep. 176; 88 Tex. 277; 53 Am. St. Rep. 752; 28 L. R. A. 761; *Houston, etc. Ry. Co. v. Strysharski*, 35 S. W. Rep. 851 (Tex.); *Houston, etc. Ry. Co. v. Kelley*, 35 S. W. Rep. 878 (Tex.); *Houston, etc. Ry. Co. v. McFadden*, 40 S. W. Rep. 216; 42 S. W. 593; 91 Tex. 194.

over mortgage bonds issued by the new company, especially where the issue of such mortgage bonds was contemplated in the reorganization agreement in pursuance of which the new company assumed payment of the claims.¹ But the general rule is that the rights of the purchaser cut in behind all contracts and conveyances of the company except such as have priority over the mortgage.² Whether any contract or conveyance made by the company after execution of the mortgage takes precedence over the bonds depends on the extent of the powers reserved to the corporation — a subject which has been already considered. Of course, the decree of sale may expressly subordinate the purchaser to contracts over which the bonds have priority,³ or the purchaser may waive his right to stand independently of such contracts.⁴

The purchaser is no more liable for debts or liabilities incurred by the receiver prior to the sale than for those incurred by the company.⁵ He is liable only in case the decree for sale makes him so,⁶ or in case he voluntarily assumes liability. In some cases, perhaps, after the property is delivered to the purchaser,

¹ *Columbus, etc. R. R. Co. Appeals*, 109 Fed. 177, 194-197; 48 C. C. A. 275.

² *Farmers' L. & T. Co. v. Chicago, etc. Ry. Co.*, 44 Fed. 653; *Roberts v. Central Trust Co.*, 128 Fed. 882; 63 C. C. A. 220 (purchaser not subject to a claim which company had contracted to pay out of proceeds of sale of the bonds); *Hukle v. Atchison, etc. Ry. Co.* (Kans.), 80 Pac. 603; *Kansas City Southern Ry. Co. v. King* (Ark.), 85 S. W. 1131 (statute making purchaser of railway liable for debts and liabilities of vendor held not to apply to purchaser at foreclosure sale); *Terre Haute, etc. Ry. Co. v. Harrison*, 96 Fed. 907; 37 C. C. A. 615.

As to the effect of a sale to a purchaser for value without notice of outstanding equities, see *U. S. v. Flint, etc. Ry. Co.*, 95 Fed. 551; 37 C. C. A. 156.

³ *St. Louis, etc. Ry. Co. v. Stark*, 55 Fed. 758; 5 C. C. A. 264; *St.*

Louis, etc. Ry. Co. v. Holbrook, 73 Fed. 112; 19 C. C. A. 385. Cf. *supra*, p. 1633, n. 2.

⁴ Cf. *Farmers' L. & T. Co. v. Chicago, etc. Ry. Co.*, 44 Fed. 653.

⁵ *Columbus, etc. R. R. Co. Appeals*, 109 Fed. 177, 198-199; 48 C. C. A. 275 (receiver's certificates); *Mercantile Trust Co. v. Kanawha, etc. Ry. Co.*, 58 Fed. 6; 7 C. C. A. 3 (receiver's certificates); *Atchison, etc. Ry. Co. v. Young*, 53 S. W. 481; 3 Ind. Ter. 60; *Houston, etc. Ry. Co. v. Bell* (Tex.), 42 S. W. 772 (tort of receiver); *Houston, etc. Ry. Co. v. Crawford*, 88 Tex. 277; 31 S. W. 176; 53 Am. St. Rep. 752; 28 L. R. A. 761.

But see *Abbot v. Jewett*, 25 Hun (N. Y.) 603. Cf. *Pittsburgh, etc. Ry. Co. v. Fierst*, 96 Pa. St. 144; and *infra*, § 2068.

⁶ *Central R. R., etc. Co. v. Farmers' L. & T. Co.*, 79 Fed. 158; *Farmers' L. & T. Co. v. Central R. R. Co.*, 17 Fed. 758.

he may, to the extent of its value, be held to respond in equity for claims arising out of the receiver's management which have enhanced the value of the property, but ordinarily all persons having such claims must look to the purchase money alone.¹

The court has no jurisdiction to entertain an intervening petition in the foreclosure suit to enforce claims against the property in the hands of the purchaser unless the right so to do was reserved before the ratification of the sale and delivery of possession to the purchaser.² But if such right is reserved, the jurisdiction of that court over such claims may be exclusive.³

§ 2036. **Distribution of Purchase Money — Whether to be made to the Trustee of the Mortgage or to the Bondholders directly.** — As stated above, the trustee of the mortgage so far represents the bondholders that he is the proper party to maintain a suit to enforce the security and that the bondholders are not necessary parties to such a proceeding. It has been said that the principle leads to the conclusion that the proceeds of any such sale should be paid to the trustee, by whom they would be distributable among the several bondholders, and that accordingly an order requiring the bondholders to appear and prove their claims before the receiver is erroneous.⁴ Even in this case, the right of any bondholder to intervene and demand payment directly to himself of his share of the purchase money was recognized; and it is believed that such intervention is convenient in practice if not obligatory in law.⁵

¹ *Chicago, etc. R. R. Co. v. McCammon*, 61 Fed. 772; 10 C. A. 50; *Mercantile Trust Co. v. Kanawha, etc. Ry. Co.*, 58 Fed. 6; 7 C. C. A. 3 (holding that a decree for sale free of liens rescinds so much of a prior order for issue of receiver's certificates as made them a prior lien on the property, and transferred the lien to the purchase money). another court on account of liabilities which he agreed to assume, see *Atchison, etc. Ry. Co. v. Cunningham* (Kans.), 54 Pac. 1055; 59 Kans. 722.

² See *supra*, § 2031, and *infra*, § 2066.

³ *Coe v. Columbus, etc. R. R. Co.*, 10 Oh. St. 372, 410-411; 75 Am. Dec. 518.

⁴ See *Hall v. Sullivan R. R. Co.*, 1 Brunner Coll. Cas. 613, 622 (semble). Cf. *Bardstown, etc. R. R. Co. v. Metcalfe*, 4 Met. (Ky.) 199; 81 Am. Dec. 541.

⁵ *Grand Trunk Ry. Co. v. Central Vermont R. Co.*, 103 Fed. 740. Cf. *Central Trust Co. v. Denver, etc. R. Co.*, 97 Fed. 239; 38 C. C. A. 143; *Zimmerman v. Kansas City, etc. R. R. Co.*, 144 Fed. 622; 75 C. C. A. 424.

As to suing the purchaser in

§ 2037-§ 2038. *Setting Sale aside for Fraud, Mistake, etc.*

§ 2037. In general — When and how the Sale may be set aside. — A foreclosure sale, like other judicial sales, may of course be set aside for fraud or collusion.¹ Few principles peculiar to our present subject are involved.² A purchase by the company's solicitor is suspicious, but not necessarily voidable.³ That the default which occasioned the sale was brought about intentionally and fraudulently by the directors will not invalidate the sale unless the trustee of the mortgage was connected with the fraud.⁴ If the circumstances are such as to justify the suspicion that the bondholders and the shareholders are attempting to "squeeze out" the general creditors, the court should not ratify the sale without investigating whether the charge of collusion can be sustained.⁵ If the directors conspire with the purchaser to let him get control of the company in consideration of their release from liability upon certain endorsements for the company, the

¹ *Jackson v. Ludeling*, 21 Wall. 616; *James v. Railroad Co.*, 6 Wall. 752; *Pac. R. R. Co. v. Missouri Pac. Ry. Co.*, 111 U. S. 505; 4 Sup. Ct. 583; *Sahlgard v. Kennedy*, 2 Fed. 295; *Farley v. St. Paul, etc. Ry. Co.*, 4 McCrary 138; *White Mts. R. R. v. White Mts. (N. H.)*, *R. R.*, 50 N. H. 50; *Anthony v. Campbell*, 112 Fed. 212; 50 C. C. A. 195. Cf. *Cutting v. B. & O. R. R. Co.*, 35 N. Y. Misc. 616; 72 N. Y. Supp. 27.

For cases in which sale was sustained against attack on the ground of fraud, see *South St. Louis, etc. Ry. Co. v. Plate*, 92 Mo. 614; 5 S. W. 199; *Messchaert v. Kennedy*, 4 McCrary 133; 13 Fed. 242; *Harpending v. Munson*, 91 N. Y. 650; *Wetmore v. St. Paul, etc. R. R. Co.*, 3 Fed. 177; *Foster v. Mansfield, etc. R. R. Co.*, 36 Fed. 627; *Fletcher v. Ann Arbor R. R. Co.*, 116 Fed. 479; 53 C. C. A. 647.

As to inadequacy of price, see

Blanks v. Farmers' L. & T. Co., 122 Fed. 849; 59 C. C. A. 59.

As to whether a shareholder or holder of bonds secured by a subsequent mortgage should be allowed to intervene for the purpose of attacking a sale for fraud, see *Central Trust Co. v. Peoria, etc. Ry. Co.* (Chamberlin's Case), 104 Fed. 418; 43 C. C. A. 613; *Central Trust Co. v. Peoria, etc. Ry. Co.* (Baldwin's Case), 104 Fed. 420; 43 C. C. A. 616.

² Cf. *Louisville Trust Co. v. Louisville, etc. Ry. Co.*, 174 U. S. 674, 681-683, 688-689; 19 Sup. Ct. 827 (where certain distinctions between foreclosure sales under ordinary mortgages and under ordinary deeds of trust to secure a series of corporation bonds were pointed out).

³ *Pacific R. R. Co. v. Ketchum*, 101 U. S. 289.

⁴ *Harpending v. Munson*, 91 N. Y. 650. Cf. *supra*, § 1982.

⁵ *Louisville Trust Co. v. Louisville, etc. Ry. Co.*, 174 U. S. 674; 19 Sup. Ct. 827.

sale will of course be set aside.¹ A bill to annul the sale must be filed promptly without laches.² The plaintiff in the foreclosure suit is a necessary party,³ as also are the trustees of the mortgage.⁴ The relief cannot ordinarily be had upon petition.⁵ An attack upon a sale for mistake and surprise, without allegation of fraud, addresses itself to the court's discretion.⁶ The fact that competition at the sale may have been "stifled" by the trustee is no ground for setting the sale aside at the instance of a person interested in a purchasing syndicate.⁷

§ 2038. **Effect of setting the Sale aside.**—Where a foreclosure sale is set aside as fraudulent against the general creditors of the company, it is still valid for all other purposes, and hence prevents another foreclosure of the same mortgage.⁸ Where a sale of a railway under a second mortgage is set aside as fraudulent against the general creditors, the purchasers who were holders of the second-mortgage bonds cannot maintain a bill in equity to recover from the first-mortgage bondholders money which they had paid to the latter in satisfaction of their claims in order to prevent a foreclosure of the prior mortgage, nor, it seems, will they be subrogated to the rights of the first-mortgage bondholders.⁹ Where a sale is set aside for reasons involving no fault on the part of the purchaser, he is entitled to be restored in all respects to his *status in quo*. For instance, where in reliance upon the validity of a sale, and in order to remove a possible cloud on the title, he has entered "satisfied" certain judgments

¹ *Drury v. Cross*, 7 Wall. 299.

⁴ *Ribon v. Railroad Cos.*, 16 Wall.

² *Harwood v. Railroad Co.*, 17 446.

Wall. 78; *Graham v. Boston, etc.*

R. R. Co., 118 U. S. 161, 179; 6 Sup.

St. 1009; *Foster v. Mansfield, etc.*

R. R. Co., 36 Fed. 627; *Raphael*

v. Rio Grande Western Ry. Co., 132

Fed. 12; 65 C. C. A. 632; *Atlantic*

Trust Co. v. New York City, 75 N.

Y. App. Div. 354; 78 N. Y. Supp.

120; *Moss v. Geddes*, 28 N. Y. Misc.

291; 59 N. Y. Supp. 867.

See *White Mts. R. R. Co. v.*

White Mts. (N. H.) R. R., 50 N. H.

50, where on the facts the objec-

tion of laches was overruled.

³ *Harwood v. Railroad Co.*, 17

Wall. 78.

⁵ *Meyer v. Utah, etc. Ry. Co.*,

3 Utah 280; 3 Pac. 393; *Wetmore*

v. St. Paul, etc. R. R. Co., 3 Fed.

177.

⁶ *Peck v. New York, etc. Ry. Co.*,

85 N. Y. 246.

⁷ *Walker v. Montclair, etc. Ry.*

Co., 30 N. J. Eq. 525. Cf. *Blanks v.*

Farmers' L. & T. Co., 122 Fed. 849;

59 C. C. A. 59 (as to estoppel to

object to sale made otherwise than

by public auction).

⁸ *Barnes v. Chicago, etc. Ry. Co.*,

122 U. S. 1; 7 Sup. Ct. 1043.

⁹ *Railroad Co. v. Soutter*, 13 Wall.

517.

against the old company, the lien of the judgments should be revived when the sale is set aside.¹

§ 2039. **Decree or Judgment against the Company In Personam.**

—As the charge by which bonds or debentures are secured usually covers, as near as may be, all of the company's assets, a decree or judgment against the company *in personam* is rarely asked. If the amount of the claim cannot be realized from the security, it cannot be obtained from a judgment against the corporation, which after the sale is generally little more than a name. Nevertheless, the holders of the bonds or debentures, if they so desire, are entitled to a judgment or decree *in personam* against the company for the balance remaining unpaid after the realization of the security.² In England, where the suit to enforce the security is brought by one debenture-holder on behalf of himself and all others, the court will not enter a personal judgment in favor of him alone, for thereby he would obtain an advantage over his fellows; nor will it enter a decree in his favor for the aggregate amount of the whole issue of debentures, for he is not a creditor to that amount: but it will make a declaration that the plaintiff and all other holders of debentures of the same series are entitled to rank as judgment creditors of the company, and will appoint a receiver for all property of the corporation not included in the debenture-holders' charge.³ Where the mortgage deed of trust contains a covenant by the company with the trustee to pay the bonds, a decree *in personam* may be entered

¹ *Hay v. Washington, etc. R. R.* Wisc. 331 (headnote inadequate); *Co.*, 4 Hughes 327. *Welsh v. First Division St. Paul, etc.*

² *Seattle, etc. Ry. Co. v. Union R. R. Co.*, 25 Minn. 314. Where a *Trust Co.*, 79 Fed. 179; 24 C. C. A. 512. Cf. *Boyce v. Continental Wire Co.*, 125 Fed. 740; 60 C. C. A. 508 (as to the effect of a failure to enter a decree *in personam* for a deficiency); *Farmers' L. & T. Co. v. American Waterworks Co.*, 107 Fed. 23 (as to distribution of money in hands of receiver representing income not covered by the mortgage securing the bonds). Cf. § 1826.

³ *Hope v. Croydon, etc. Tramways*, 34 Ch. D. 730. Cf. *Chicago, etc. R. R. Co. v. Fosdick*, 106 U. S. 47, 84-85; 1 Sup. Ct. 10; *Seattle, etc. Ry. Co. v. Union Trust Co.*, 79 Fed. 179, 187-188; 24 C. C. A. 512. But see *Jesup v. City Bank*, 14

up in favor of the trustee in a foreclosure suit prosecuted by him for any sum remaining due upon the bonds after distribution of the proceeds of sale,¹ and such a decree will be a bar to any subsequent action by an individual bondholder.²

Of course if the property covered by the security is insufficient to pay the bonds or debentures in full, the bondholders or debenture-holders may prove for the unpaid balance along with the general creditors in any winding-up or bankruptcy proceedings.³ The right of the several bondholders to sue at law on bonds held by them respectively is considered above.⁴

§ 2040. **Reformation of Mistake in Deed of Trust.** — Under the prayer for general relief in a suit for foreclosure, or for a sale in lieu of foreclosure, the court may decree a reformation of a mistake in the mortgage.⁵

§ 2041-§ 2069. PREFERENTIAL CLAIMS ARISING IN COURSE OF THE RECEIVERSHIP.

§ 2041. **In general — Priority of Expenses of the Receivership.** — In the course of the receivership and of the proceedings culminating in the sale, costs and expenses of various kinds are necessarily incurred. Having discussed above the rules of priority which apply as between the bonds or debentures and other claims originating while the company continues to be a going concern, we must now consider claims which arise in the course of the receivership. The simplest example of claims of this latter sort are claims for court costs.⁶ Other examples are the receiver's salary or compensation, operating expenses during the receiver-

¹ *Grant v. Winona, etc. Ry. Co.*, 36 Vt. 452; *Randolph v. New Jersey*, 89 N. W. 60; 85 Minn. 422. Cf. *etc. R. R. Co.*, 28 N. J. Eq. 49.
Conner v. Bramble, 6 Oh. N. P. 195.

² *Grant v. Winona, etc. Ry. Co.*, 89 N. W. 60; 85 Minn. 422; *Laing v. Queen City Ry. Co. (Tex.)*, 49 S. W. 136.

³ *Ex parte Bradshaw*, 15 Ch. D. 465; *Pattberg v. Pattberg Bros.*, 38 Atl. 205; 55 N. J. Eq. 604.

⁴ *Supra*, § 1892.

⁵ *Coe v. New Jersey Midland Ry. Co.*, 31 N. J. Eq. 105, 121-122. Cf. *Miller v. Rutland, etc. R. R. Co.*, 36 Vt. 452; *Randolph v. New Jersey*, 89 N. W. 60; 85 Minn. 422. ⁶ That costs in this connection include the plaintiff's solicitor's fee and are not limited to costs as between party and party, see *supra*, § 1976.

That neither the company nor second-mortgage bondholders who were made defendants are entitled to their costs in case of an insufficiency of the security, see *Clayton Engineering & Electrical Const. Co.*, 90 L. T. 283.

ship, etc. All such claims as a matter of course take priority over the bonds or debentures themselves;¹ for the court steps in and appoints the receiver for the benefit of the bondholders and at the instance of them or their representative; and therefore the expenses of the receivership, being deemed to have enured to the benefit of the bondholders, take precedence over them.² Otherwise the business of an insolvent company could not be carried on by the receiver. These expenses of the receivership constitute a prior charge, not merely on the income of the receivership, but also on the corpus of the property covered by the lien of the bonds.³ This is true although the order of court appointing the receiver directed that such expenses should be borne by the income of the receivership.⁴

§ 2042. **Excess of Expenses over Amount realized from the Receivership — By whom to be borne.** — Inasmuch as the receiver is appointed at the instance of the bondholders or of their representative, it has been held by lower federal courts that if the proceeds of sale of the mortgaged property be insufficient to defray the expenses of the receivership, a decree may pass for the payment of the deficiency by the plaintiff in the case;⁵ but this decision was reversed on appeal,⁶ in accordance with the weight of authority.⁷ The true doctrine would seem to be that such expenses constitute costs in the case, and as such may be imposed upon any party thereto in the discretion of the

¹ *Hale v. Nashua, etc. R. R.*, 60 N. H. 333, 341. Cf. *Langdon v. Vermont, etc. R. R. Co.*, 54 Vt. 593.

Vermont, etc. R. R. Co., 54 Vt. 593; But see *Hand v. Savannah, etc. Metropolitan Trust Co. v. Tona-* *R. R. Co.*, 17 S. Car. 219, 266-272.

wanda, etc. R. R. Co., 103 N. Y. 245; 8 N. E. 488. ⁴ *Union Trust Co. v. Illinois Mid-* *land Ry. Co.*, 117 U. S. 434, 465;

Where a receiver is refused, the president of the company caring for the property pending a sale, he is entitled to compensation out of the proceeds of sale. *Trust & Deposit Co. v. Spartanburg Water-* *works Co.*, 97 Fed. 409.

² Cf. *infra*, § 2043. ⁵ *Chapman v. Atlantic Trust Co.*, 119 Fed. 257; 145 Fed. 820.

³ *Union Trust Co. v. Illinois Midland Ry. Co.*, 117 U. S. 434, 464-465; 6 Sup. Ct. 809; *Kneeland v. Bass Foundry, etc. Works*, 140 U. S. 592; *McLane v. Placerville, etc. R. R. Co.*, 66 Cal. 606; *Langdon* n. 6).

⁶ *Atlantic Trust Co. v. Chapman*, 208 U. S. 360. ⁷ *Farmers' L. & T. Co. v. Oregon Pac. R. R. Co.*, 31 Oreg. 237; 48 Pac. 706; 65 Am. St. Rep. 822;

38 L. R. A. 424. Cf. *Hendrie, etc. Mfg. Co. v. Parry (Colo.)*, 86 Pac. 113; *Clayton Engineering and Electrical Const. Co.*, 90 L. T. 283 (stated *supra*, p. 1639,

court; but it is submitted that this discretion should rarely be exercised so as to cast such heavy burdens on a successful plaintiff who has been so unfortunate as to lose the fruits of his victory by the inadequacy of the security. In the ordinary case of an insufficiency of the mortgaged property to pay the expenses of the receivership, a decree *in personam* should pass against the company for their payment, and if the company be without funds, they should go unpaid.

§ 2043. **Expenses of Receiver not appointed at the Instance of the Bondholders or their Trustee.**—When it is said that the expenses of the receivership have priority over the mortgage bonds, all that is meant is that such expenses outrank the bonds for the benefit of which the receivership is instituted and carried on. The priority of other bonds secured by a prior mortgage is not disturbed, even though the trustee for the holders of those other bonds is a party to the suit. Of course, if a sale is made free and clear of the prior mortgage, the suit is converted virtually into a suit to enforce that security, and the same principles apply as if it had been originally instituted for that purpose; but where the sale is subject to the prior mortgage, the holders of the first-mortgage bonds cannot be required to contribute to the expenses of the sale or the receivership.¹ Upon the same principle, the expenses of a receiver appointed at the instance of unsecured creditors, or shareholders, do not have priority over mortgage bonds.² On the other hand, expenses of a receiver appointed at the instance of shareholders for the operation of a railway for a brief period before the appointment of a receiver at the instance of mortgage bondholders may have priority over the bonds under the doctrine of *Fosdick v. Schall*.³

¹ *Tome v. King*, 64 Md. 166; 21 Atl. 279. Cf. *Phinizy v. Augusta*, 128 Fed. 209; 62 C. C. A. 657; etc. *R. R. Co.*, 62 Fed. 771; *Clarke Seiler v. Union Mfg. Co.*, 50 W. Va. 556; *Central R. R., etc. Co.*, 54 Fed. 208; 40 S. E. 547. Cf. *Pennsylvania Co. v. Central Trust Co.*, 71 Fed. 776; *Third Street, etc. Ry. Co.*, 93 Fed. 60; 35 C. C. A. 202; *Co. v. Lewis*, 79 Fed. 196; 24 C. C. 482; *New York Security, etc. Co. v. Louisville, etc. Co.*, 102 Fed. 382.

² *Atlantic Trust Co. v. Dana*, 74 Fed. 335.

³ *Ames v. Union Pac. Ry. Co.*,

§ 2044-§ 2048. *What are deemed to be Claims for operating Expenses of Receivership and as such entitled to Priority.*

§ 2044. **In general.** — It is very difficult to lay down any helpful rules for determining what are operating expenses of a receivership and as such entitled to priority.¹ The whole matter rests largely within the discretion of the court, to be exercised with reference to the facts of each particular case. Thus, it has been held that the cost of preventing the subsidizing of a rival company cannot be deemed operating expenses.² Moreover, it has been held in England that where the receiver prosecutes litigation in the name of the company and the costs of the opposite party are ultimately ordered to be paid by the company, such costs do not constitute a preferential claim on the proceeds of sale realized by the receiver.³ But the payment to connecting lines of railroad of their just and equitable share of interchanged business is part of the operating expenses of a railway receivership.⁴

§ 2045. **Receiver's Right of Indemnity.** — For all outlays which a receiver in the course of his duty may make he has a right of indemnity out of the assets in his hands, which constitutes a prior claim thereon.⁵

¹ In addition to cases cited *infra*, *Co. v. Texas Pac. Ry. Co.*, 41 Fed. see *Phinizy v. Augusta, etc. R. R.* 319; *Thomas v. East Tennessee, Co.*, 62 Fed. 771; *Ames v. Union etc. Ry. Co.*, 60 Fed. 7. See also *Pac. Co.*, 74 Fed. 335; *Union Loan & Trust Co. v. Southern Cal. Motor* supra, § 87.

Road Co., 49 Fed. 267 (expense of paving street between rails in obedience to municipal authorities not entitled to preference where there is no lien for such expenditures); *Pennsylvania Co. v. Jacksonville, etc. Ry. Co.*, 93 Fed. 60; 35 C. C. A. 202 (fees of counsel for receiver); *Grand Trunk Ry. Co.*, 88 Fed. 636.

As to fees of receiver's counsel, see further, *supra*, § 2018.

As to payment of gratuities to employees of receiver, see *Missouri Pac. Ry. Co. v. Texas, etc. Ry. Co.*, 33 Fed. 701; *Missouri Pac. Ry.*

Fees of counsel who defend the foreclosure suit or the salary of the company's secretary accruing after the appointment of the receiver cannot be deemed expenses of the receivership. *Union Loan, etc. Co. v. Southern Cal., etc. Road Co.*, 51 Fed. 106.

² *Cowdrey v. Galveston, etc. R. R. Co.*, 93 U. S. 352.

³ *Griffiths Cycle Corp.*, 85 L. T. 675, affirmed 85 L. T. 776.

⁴ *Ames v. Union Pac. Ry. Co.*, 73 Fed. 49.

⁵ Cf. *Ames v. Union Pac. Ry. Co.*, 74 Fed. 335; *Northern Alabama Ry.*

§ 2046. **Claims for Torts committed in the Course of the Business.** — Claims against a receiver for torts committed by his servants in the management or conduct of the business constitute expenses of the receivership within the meaning of the rule now being considered, and as such are entitled to priority over the bonds or debentures.¹ According to one view of a receiver's liability, the priority of claims of this sort may be rested upon the ground that the receiver is personally liable and is therefore entitled to indemnity from the assets for a personal liability to pay such charges; but, as we have seen, this view of a receiver's liability is not prevalent in America.

§ 2047. **Claims against Receiver on Contracts — Authority of Receiver to contract.** — Any claims upon contracts which the receiver may lawfully and properly make will be entitled to priority. For instance, a claim for breach of an agreement of the receiver to repair certain cars rented to him will have priority over the bonds.² But persons who contract with a receiver will not be entitled to a preference over the bondholders, if indeed they have any claim against the assets at all, unless they can show that the contract was one which the receiver was expressly or impliedly authorized to make.³ The receiver's contracts of loan

Co. v. Hopkins, 87 Fed. 505 (traveling expenses of receiver).

This right being a personal one, survives to the receiver's executor. *Cake v. Woodbury*, 3 App. Cas. (D. C.) 60.

¹ *Anderson v. Condict*, 93 Fed. 349; 35 C. C. A. 335; 94 Fed. 716; 36 C. C. A. 437; *Cross v. Evans*, 86 Fed. 1; 29 C. C. A. 523; *Cowdrey v. Galveston, etc. R. R. Co.*, 93 U. S. 352; *St. Louis, etc. Ry. Co. v. Holbrook*, 73 Fed. 112; 19 C. C. A. 385. Cf. *Grand Trunk Ry. Co. v. Central Vt. R. Co.*, 81 Fed. 60; *Davenport v. Receivers*, 2 Woods 519.

But see *Hand v. Savannah, etc. R. R. Co.*, 17 S. Car. 219, 271-272.

² *Thomas v. Western Car Co.*, 149 U. S. 95; 13 Sup. Ct. 824; *Mercantile Trust, etc. Co. v. Southern Iron Car Line*, 113 Ala. 543; 21 So. 373.

³ In addition to cases cited below, see *Vanderbilt v. Central R. R. Co.*, 43 N. J. Eq. 669; 12 Atl. 183 (containing a full discussion of the subject of receivers' contracts); *Cowdrey v. Railroad Co.*, 1 Woods 331; *International, etc. Ry. Co. v. Wentworth*, 8 Tex. Civ. App. 5; 27 S. W. 680; *International, etc. R. Co. v. Herndon*, 33 S. W. Rep. 377; 11 Tex. Civ. App. 465; *Bayles v. Kansas Pac. Ry. Co.*, 13 Col. 181; 22 Pac. 341; 5 L. R. A. 480; *Vilas v. Page*, 106 N. Y. 439; 13 N. E. 743; *Metropolitan Trust Co. v. Tonawanda, etc. R. R. Co.*, 103 N. Y. 245, 250-251; 8 N. E. 488; *British Power Traction, etc. Co.* (1906), 1 Ch. 497; *British Power Traction Co. (No. 2)*, (1907) 1 Ch. 528.

But see *Smith v. London United Breweries* (1907), 2 Ch. 511.

As to increase or reduction of

will be considered in detail below.¹ The receiver has no authority to take a long-term lease of office apartments without an order of court;² but under a decree giving general authority to the receiver to carry out and renew all contracts that the company may have made, the receiver may renew a lease of rolling stock.³ And, in general, the receiver will be held to have implied power to make any contracts that are customary in the conduct of such businesses as that which he was appointed to manage.⁴ For instance, the Supreme Court of the United States has recently held that a receiver appointed to manage a railway is authorized to contract for shipment of goods beyond the line in his possession, so as to become liable for a default of the connecting carrier.⁵

§ 2048. **Analogy of Cases as to "Working Expenses" in an English Railway Receivership.** — Upon the question what charges are to be deemed expenses of a receivership and as such entitled to a preference, some light may be thrown by cases construing a British statute which provides that in cases of railway receiverships the "working expenses" shall first be paid. It has been held that where the railway company purchases rolling stock upon the terms of paying for it in instalments, the vendor retaining title until all the instalments are paid and reserving the right to seize the stock on default in any instalment, the instalments of the purchase money as they fall due constitute "working expenses" within the meaning of this act.⁶ So, the rental of rolling stock is comprised within the term "working expenses."⁷ On the other hand, the expense of promoting a bill in Parliament to increase the company's powers cannot be deemed "working ex-

the wages of a receiver's employees, *Cake v. Woodbury*, 3 App. Cas. (D. C.) 60; *South Carolina v. Port Royal, etc. Ry. Co.*, 89 Fed. 565;

¹ *Infra*, § 2049 et seq.

² *Chicago Deposit Vault Co. v. San Antonio, etc. Ry. Co. v. Barnett McNulta*, 153 U. S. 554; 14 Sup. (Tex.), 44 S. W. 20.

Ct. 915.

³ *Northern Pac. Ry. Co. v. Am.*

But see *Girard Ins. Co. v. Cooper, Trading Co.*, 195 U. S. 439, 461-162 U. S. 529, 544; 16 Sup. Ct. 879. 462; 25 Sup. Ct. 84.

⁴ *Mercantile Trust, etc. Co. v. Southern Iron Car Line*, 113 Ala. 543; 21 So. 373. ⁶ *Eastern & Midlands Ry. Co.*, 45 Ch. D. 367. Cf. *Frank v. Denver, etc. Ry. Co.*, 23 Fed. 123 (headnote

⁷ *Cornwall Minerals Ry. Co.*, 48 ⁴ Cf. *Kansas Pac. Ry. Co. v. Bayles*, 19 Colo. 348, 353-354 (headnote inadequate); 35 Pac. 744; L. T., N. S., 41.

penses.”¹ The inference should not be drawn, however, that no charges should be allowed priority as expenses of the receivership unless they would constitute “working expenses” within this British statute.

§ 2049-§ 2065. *BORROWING BY RECEIVER.*

§ 2049-§ 2057. *POWER OF RECEIVER TO BORROW AND TO SECURE REPAYMENT BY A PRIOR CHARGE ON THE ASSETS.*

§ 2049. **In general.** — Instead of permitting the expenses of the receivership to accumulate and constitute in themselves a prior charge upon the property in the receiver's hands, the court may authorize the receiver to borrow money to pay for such expenses upon the stipulation that the amount so borrowed shall be a first lien upon the company's property, coming in ahead even of the mortgage bonds. This power is often spoken of as the extreme limit of the most extraordinary powers of a court of chancery; and it is indeed capable of great abuse, and sometimes has doubtless been abused. But considered in itself, it is seen to be, when cautiously applied, no real extension of the power to appoint a receiver and to make his expenses a first lien on the property or funds coming to his hands.

§ 2050. **Necessity for affording Bondholders Opportunity to oppose Grant to Receiver of Authority to borrow.** — The power, therefore, to authorize the receiver to borrow money with priority over the mortgage bonds or debentures may be exercised by the court in any properly framed suit for the enforcement or foreclosure of their security, even though some of the bondholders or debenture-holders are in court only by representation, the suit having been brought by one of their number on behalf of all.² *A fortiori*, the trustee of an American corporation mortgage is a

¹ *Mersey Ry. Co.*, 64 L. J. Ch. 623. fellow-bondholders, a New York court has held that receivers' certificates issued therein are not entitled to priority over the claims of the other bondholders. *Stevens v. Union Trust Co.*, 57 Hun (N. Y.) 498; 11 N. Y. Supp. 268.

² *Greenwood v. Algeciras Ry. Co.* (1894), 2 Ch. 205. Cf. *Strapp v. Bull* (1895), 2 Ch. 1.

But if the plaintiff in such a suit does not honestly strive to support the best interests of his

sufficient representative of the bondholders;¹ and of course, therefore, the bondholders are barred by the laches of their trustee in failing to object to the order making the receiver's indebtedness a paramount lien.² The fact that the bill on which the receiver was appointed and authorized to borrow was demurrable will not necessarily invalidate the certificates issued in pursuance of the order of court.³ But the court has no power to authorize such a borrowing unless the holders of the bonds or debentures are parties to the cause either personally or by representation, and have an opportunity to be heard in opposition.⁴ Hence, in an English winding-up, to which debenture-holders are not parties, the court has no power to authorize the liquidator to borrow upon the terms that the lender shall have priority over the debenture-holders.⁵ The meaning of this proposition that a receiver cannot be authorized to borrow in priority over the holders of bonds or debentures unless the latter are in court either personally or by representation is merely that in such cases the lender will not be entitled to priority unless the court after hearing the bondholders or debenture-holders shall determine the case to be one in which an order to authorize such borrowing is proper. In other words, the lender merely takes the risk of the

¹ *Wallace v. Loomis*, 97 U. S. 383; *Ex Parte Mitchell*, 12 S. Car. 83; 146, 163 (headnote inadequate).

² *Union Trust Co. v. Illinois Midland Ry. Co.*, 117 U. S. 434, 463-464; 6 Sup. Ct. 809; *Rochester Trust, etc. Co. v. Oneonto, etc. R. R. Co.*, 107 N. Y. Supp. 237. Cf. *Kent v. Lake Superior, etc. Co.*, 144 U. S. 75; 12 Sup. Ct. 650; *Central Trust Co. v. Seasongood*, 130 U. S. 482; 9 Sup. Ct. 575; *Miltenberger v. Logansport Ry. Co.*, 106 U. S. 286, 306-308; 1 Sup. Ct. 140.

But see *Belknap Savings Bank v. Lamar Land, etc. Co.*, 64 Pac. 212; 28 Colo. 326 (where the trustee had abandoned the trust).

³ *Farmers' L. & T. Co. v. Centralia, etc. R. Co.*, 96 Fed. 636.

⁴ Cf. *Meyer v. Johnston*, 53 Ala. 237, 349-350; *Raht v. Attrill*, 106 N. Y. 423; 13 N. E. 282; 60 Am. Rep. 456; *State v. Port Royal, etc. Ry. Co.*, 45 S. Car. 470; 23 S. E.

Mercantile Trust Co. v. Kanawha, etc. Ry. Co., 58 Fed. 6; 7 C. C. A. 3; *Laughlin v. U. S. Rolling Stock Co.*, 64 Fed. 25; *Smiley v. Sioux Beet Syrup Co.* (Nebr.), 99 N. W. 263; 101 N. W. 253; *Royal Trust Co. v. Washburn, etc. Ry. Co.*, 120 Fed. 11; 57 C. C. A. 31 (where receiver's certificates were held to have priority over a vendor's lien, *sed quare de hoc*); *Farmers' L. & T. Co. v. Centralia, etc. R. Co.*, 96 Fed. 636 (where the trustee of the mortgage had notice of the application but, although named as party in the bill, had never been served with process); *Bibber-White Co. v. White River, etc. Co.*, 115 Fed. 786; 53 C. C. A. 282; *Bernard v. Union Trust Co.*, 159 Fed. 620.

⁵ *Regent's Canal Ironworks Co.*, 3 Ch. D. 411.

court's deciding, after the bondholders are brought into court and given a hearing, that the circumstances of the case do not justify giving priority to the loan.¹

§ 2051. **Necessity for prior Express Order of Court to authorize Receiver to borrow.** — The mere appointment of a receiver gives him no implied authority to borrow money secured by a paramount lien upon the property of the corporation.² Of course, if a person lends money to a receiver upon the faith of the latter's assurance that an order of court will be obtained making the loan a paramount lien, and if the order is accordingly applied for and granted by the court, the lender has the same rights as if the sanction of the court had been obtained prior to the advance.³ If he advances his money before the order of court, he simply takes the chance of a refusal by the court to give him the expected priority, without any possibility of successfully contending that the receiver has pledged the faith of the court.⁴ Moreover, since the courts are not disposed to encourage receivers in borrowing money without prior explicit sanction, unless in some dire emergency, the court will be very apt to refuse to grant the lender the anticipated priority.⁵

§ 2052. **Ratification by Court and Receiver of unauthorized Borrowing by Agent.** — The borrowing of money by a fiscal agent of the receiver and the issue of receiver's certificates therefor, even though at the time unauthorized by the receiver and the court, may yet be ratified by the receiver and approved by the court, so as to give priority to the certificates, provided the money

¹ *Union Trust Co. v. Illinois Midland Ry. Co.*, 117 U. S. 434, 456; 6 Sup. Ct. 809; *Farmers' L. & T. Co. v. Centralia, etc. R. Co.*, 96 Fed. 636 (where the receiver's certificates which were issued to pay off claims having a prior lien to the bonds were allowed priority, but certificates used to pay off junior incumbrances were not given priority).

Cf. *Meyer v. Johnston*, 53 Ala. 237, 350-351; *Mercantile Trust Co. v. Missouri, etc. Ry. Co.*, 41 Fed. 8.

² As to the supposed implied power of the receiver to borrow money in the ordinary course of

the business, compare *British Power Traction, etc. Co.* (1906), 1 Ch. 497; *British Power Traction Co. (No. 2)*, (1907) 1 Ch. 528; *Smith v. London United Breweries* (1907), 2 Ch. 511.

³ *Lathom v. Greenwich Ferry Co.*, 72 L. T. 790; *Crosby v. Morristown, etc. R. R. Co.* (Tenn.), 42 S. W. 507, 517-518. Cf. *Smith v. London United Breweries* (1907), 2 Ch. 511.

⁴ Cf. *State v. Port Royal Ry. Co.*, 45 S. Car. 470.

⁵ *Union Trust Co. v. Illinois Midland Ry. Co.*, 117 U. S. 434, 476-479; 6 Sup. Ct. 809; *British Power Traction Co. (No. 2)*, (1907) 1 Ch. 528 (overdraft at a bank).

has come to the receiver's hands — for example, by being deposited in bank to his credit.¹

§ 2053-§ 2054. *Construction of Order of Court as to Borrowing by Receiver.*

§ 2053. **Extent of Priority Receiver may confer upon Lender.**

— An order authorizing the receiver to “raise” money confers upon him authority to give the lender priority even over the holders of bonds or debentures.² And if the order of court under which the loan is effected does not limit the borrower's priority to a particular fund, the priority extends to any assets in the receiver's hands, even though the petition on which the order was passed prayed that the money should be payable out of a special fund.³

§ 2054. **Orders limiting Amount which Receiver may borrow.** —

Where a receiver is authorized to borrow to a limited amount, and he borrows a part of that amount and is repaid, his original borrowing power is not diminished, but may be exercised as though he had never borrowed at all.⁴ Where the receiver is authorized to borrow a limited amount, for the general purposes of the business, an overdraft at the receiver's bankers in excess of that amount is unwarranted, and will not have priority over the bonds or debentures unless the court is satisfied that under the circumstances the receiver was justified in contracting the obligation without first obtaining the leave of court and that prior authority if applied for would have been granted.⁵

§ 2055. **For what Purposes Receiver may be authorized to borrow.** — The purposes for which the court will exercise this power of borrowing money with a priority over the mortgage

¹ *Alabama, etc. Ry. Co. v. Anniston, etc. Trust Co.*, 57 Fed. 25; 6 C. C. A. 242. Cf. *Crosby v. Morristown, etc. R. R. Co.* (Tenn.), 42 S. W. 507 (where certificates issued by a receiver appointed by a court which had no jurisdiction of the subject matter were ratified by the lawful receiver and by the court appointing him).

² *Lathom v. Greenwich Ferry Co.* (1906), 1 Ch. 497.

Co., 72 L. T. 790 (headnote misleading).

³ *Neafie's Appeal*, 12 Atl. Rep. 271 (Pa.). As to whether the lender's priority cuts in behind claims which have priority over the mortgage bonds, compare *infra*, § 2057.

⁴ *Milward v. Avill*, 4 Manson 403.

⁵ *British Power Traction, etc.*

indebtedness rest largely within the judicial discretion. The power will be exercised in order to keep a railway open for traffic,¹ particularly when this course is necessary in order to prevent a forfeiture of the charter or concession,² to obtain money for ordinary repairs of a railway,³ or to pay off tax-liens.⁴ The court will be reluctant to exercise this power for the purpose of completing an unfinished railway, and except in extraordinary circumstances will decline to do so.⁵ Nor can the court properly authorize the borrowing of money with priority to the mortgage bonds for the purpose of paying off claims over which the bonds have priority, however practically desirable such a course may be.⁶ Nor should receiver's certificates be issued for the purpose of obtaining funds to pay overdue coupons and thus to prevent the principal of the bonds from becoming forthwith due.⁷ On the other hand, the receiver may be authorized to borrow in order to pay off preferred claims, such as labor and supply claims, which are entitled to preference under the rule in *Fosdick v. Schall*.⁸ The receiver will not be permitted to borrow even for the purpose of acquiring necessary supplies or equipment if sufficient funds for such expenses are on hand in the shape of earnings, merely in order to apply such earnings to the payment of interest on the bonds.⁹ For any purpose, the court may author-

¹ *Meyer v. Johnston*, 53 Ala. 237, 346-350.

² *Greenwood v. Algeciras Ry. Co.* (1894), 2 Ch. 205; *Wallace v. Loomis*, 97 U. S. 146, 162. Cf. *Kennedy v. St. Paul, etc. R. R. Co.*, 5 Dill. 519; *Merchants', etc. Co. v. Chicago Rys. Co.*, 158 Fed. 923; *Guaranty Trust Co. v. Chicago, etc. Co.*, 158 Fed. 1015.

³ *Union Trust Co. v. Illinois Midland Ry. Co.*, 117 U. S. 434, 454; 6 Sup. Ct. 809; *Meyer v. Johnston*, 53 Ala. 237, 346-350; *Hilton Bridge, etc. Co. v. Foster*, 26 N. Y. Misc. 338; 57 N. Y. Supp. 140 (rebuilding dangerous bridges); *Sage v. Shore Line Ry. Co.*, 2 New Brunsw. Eq. 321.

But see *Credit Co. v. Arkansas, etc. R. R. Co.*, 15 Fed. 46; *Investment Co. v. Ohio, etc. Co.*, 36 Fed. 48.

⁴ *Union Trust Co. v. Illinois Midland Ry. Co.*, 117 U. S. 434, 461; 6 Sup. Ct. 809.

⁵ *Shaw v. Railroad Co.*, 100 U. S. 605; *Meyer v. Johnston*, 53 Ala. 237, 335-346; *Kennedy v. St. Paul, etc. R. R. Co.*, 5 Dill. 519; *Investment Co. v. Ohio, etc. R. R. Co.*, 36 Fed. 48. Cf. *Rochester Trust, etc. Co. v. Oneonta, etc. R. R. Co.*, 107 N. Y. Supp. 237.

⁶ *Raht v. Attrill*, 106 N. Y. 423; 13 N. E. 282; 60 Am. Rep. 456; *Metropolitan Trust Co. v. Tona-wanda, etc. R. R. Co.*, 103 N. Y. 245; 8 N. E. 488.

⁷ *Townsend v. Oneonta, etc. Ry. Co.*, 88 N. Y. App. Div. 208; 84 N. Y. Supp. 427.

⁸ *Taylor v. Philadelphia, etc. R. R. Co.*, 7 Fed. 377.

⁹ *Taylor v. Philadelphia, etc. R. R. Co.*, 9 Fed. 1.

ize the issue of receiver's certificates which shall be prior in lien only to those bondholders who assent to the issue.¹

§ 2056. **Borrowing by Receiver of Corporation not engaged in Public Service — Whether Court may authorize.** — The power of courts to authorize receivers to borrow has been most frequently invoked in the case of railroad companies; but as the principle is a general one, there seems no reason to doubt that it should be applied, in a proper case, to other sorts of corporations.² The more speculative and uncertain the business, the more reluctant the court will be to authorize money to be borrowed for the sake of keeping it alive. The court refused to approve a borrowing of money in order to keep a theatre open, and thus enable it to be sold as a going concern.³ And so, too, borrowing for the purpose of continuing the business of irrigating and colonizing arid lands will not be sanctioned.⁴

§ 2057. **Limits of Lender's Priority — Priority over Incumbrances which have Priority over the Mortgage being enforced.** — This power of courts of equity to authorize receivers to borrow money secured by a charge upon the assets prior to existing liens ordinarily extends merely to the power of giving a preference over the mortgage that is being enforced and over liens junior thereto.⁵ For example, in a suit to enforce a second mortgage, the court will not ordinarily authorize the receiver to borrow with priority over the first-mortgage bondholders.⁶ Even under such circum-

¹ Cf. *Investment Co. v. Ohio, etc. R. R. Co.*, 36 Fed. 48, 53.

² *Ellis v. Vernon, etc. Water Co.*, 86 Tex. 109; 23 S. W. 858. Cf. *Neafie's Appeal* (Pa.), 12 Atl. 271 (a case of a ship-building company); *Karn v. Rorer Mining Co.*, 86 Va. 754; 11 S. E. 431 (a case of a mining company owning auxilliary railway); *Erie Lumber Co.*, 150 Fed. 817, 828 (depending on a federal statute which authorizes receiver of bankrupt corporation to continue the business).

But see *Hanna v. State Trust Co.*, 70 Fed. 2; 16 C. C. A. 586; 30 L. R. A. 201; *Fidelity Ins., etc. Co. v. Roanoke Iron Co.*, 68 Fed. 623; 201.

Hooper v. Central Trust Co., 81 Md. 559, 591-593; 32 Atl. 505; 29 L. R.

A. 262; *Belknap Savings Bank v. Lamar Land, etc. Co.*, 64 Pac. 212;

28 Colo. 326; *Lamar Land, etc. Co. v. Belknap Sav. Bank*, 64 Pac. 210; 28 Colo. 344; *Baltimore Bldg., etc. Ass'n v. Alderson*, 90 Fed. 142; 32 C. C. A. 542; *International Trust Co. v. Decker Bros.*, 152 Fed. 78.

³ *Securities, etc. Corp. v. Brighton Alhambra*, 62 L. J. Ch. 566; 68 L. T. 249.

⁴ *Hanna v. State Trust Co.*, 70 Fed. 2; 16 C. C. A. 586; 30 L. R. A. 201.

⁵ Cf. *supra*, § 2043 and § 2053.

⁶ *Hanna v. State Trust Co.*, 70 Fed. 2; 16 C. C. A. 586; 30 L. R. A. 201.

But see *Central Trust Co. v. Marietta, etc. Ry. Co.*, 75 Fed. 193;

stances, however, the borrowing may be authorized for the purpose of paying taxes which constitute a prior lien to all the bonds.¹

§ 2058-§ 2063. *Acknowledgments of Indebtedness given by Receivers — Receivers' Certificates.*

§ 2058. **In general.** — Whenever the receiver is authorized to borrow, he is also authorized to give some acknowledgment or evidence of the loan. These acknowledgments are called in America "receiver's certificates."

§ 2059. **Whether Negotiable.** — These instruments are intended to pass freely from hand to hand, and are often dealt in on the stock exchange. Nevertheless, it has been said that they are not negotiable.² This statement should not, however, be accepted without reservation. Doubtless it is true that unless the certificates were issued under the circumstances contemplated in the order of court authorizing their issue, a purchaser for value would have no greater rights than the original holder.³ Hence, if the amount which the receiver may borrow be limited, any certificates given by him for money borrowed in excess of that limit are void even in the hands of an innocent purchaser.⁴ But if the court should authorize the receiver to issue a series of certificates, and if some of them should be issued by him subject to some corrupt bargain that would invalidate them in the hands of an original holder, yet might not a *bona fide* purchaser for value acquire greater rights? On principle it would perhaps seem so.⁵ And certainly where the certificates purport to be

21 C. C. A. 291; s. c., 75 Fed. 209; Am. Rep. 144; *Union Trust Co. v. Chicago, etc. R. R. Co.*, 7 Fed. 513. Cf. *Swann v. Clark*, 110 U. S. 602.

³ *Bank of Montreal v. Chicago, etc. R. R. Co.*, 48 Iowa 518; *Stanton v. Alabama, etc. R. R. Co.*, 2 Woods 506; *Stanton v. Alabama, etc. R. R. Co.*, 31 Fed. 585. Cf. *Bernard v. Union Trust Co.*, 159 Fed. 620.

⁴ *Newbold v. Peoria, etc. R. R. Co.*, 5 Ill. App. 367.

⁵ Cf. *Alabama, etc. Ry. Co. v. Anniston, etc. Trust Co.*, 57 Fed. 456; 6 Sup. Ct. 809; *Turner v. Peoria, etc. R. R. Co.*, 95 Ill. 134; 35

payable to bearer, they would be negotiable as between successive holders, so as to pass title, for example, to a *bona fide* purchaser from a thief.

§ 2060. **As Pledges of the Faith of the Court.** — Where receiver's certificates are issued in pursuance of an order of court passed within its jurisdiction, the faith of the court is pledged to their payment according to their terms; and the fact that the issue may have been improvident or that payment in the manner stipulated for would be prejudicial to the management of the business by the receiver is no cause for permitting him to depart from the terms of the contract.¹

§ 2061. **Liability of Receiver for False Recitals in Certificates.** — Representations or recitals contained in receiver's certificates may, if false and fraudulent, constitute ground for an action of deceit against the receiver individually;² but they do not amount to warranties upon which suit can be maintained against him without proof of fraud.³

§ 2062. **Delegation by Receiver of Duty of issuing Certificates.** — It has been said that a receiver has no power to delegate the duty of selling or negotiating the receiver's certificates;⁴ but if this be true, certainly the court would in any ordinary case upon application expressly authorize such delegation. Reasons of convenience so demand.

§ 2063. **Issue of Receiver's Certificates for Obligations other than Loans.** — Instead of authorizing the receiver to borrow money to pay off maturing bonds secured by a prior charge on part of the property, the court may authorize him to enter into an agreement with the holders of such bonds by which in consideration of their forbearance he is to issue his certificates for interest during the period of forbearance.⁵ So, instead of borrowing money wherewith to make necessary repairs to the corporate property, the receiver may be authorized to issue his

R. R. Co., 95 Ill. 134; 35 Am. Rep. 144 (where receivers' certificates were issued without consideration). Cf. *Bank of Montreal v. Chicago*, etc. *R. R. Co.*, 48 Iowa 518; *Stanton v. Alabama*, etc. *R. R. Co.*, 2 Woods 506; *Stanton v. Alabama*, etc. *R. R. Co.*, 31 Fed. 585; *Union Trust Co. v. Chicago*, etc. *R. R. Co.*, 7 Fed. 513.

¹ *United States Rolling Stock Co.*, 57 How. Pr. 16.

² *Bank of Montreal v. Thayer*, 7 Fed. 622.

³ *Bank of Montreal v. Thayer*, 7 Fed. 622.

⁴ *Union Trust Co. v. Chicago*, etc. *Ry. Co.*, 7 Fed. 513.

⁵ *Skiddy v. Atlantic*, etc. *R. R. Co.*, 3 Hughes 320.

certificates in payment for the work done.¹ In any case, the priority exists, or may exist, quite independently of the certificates, which are issued merely for commercial convenience in assigning the claims, etc. Where the court authorized a receiver to issue his certificates for "money borrowed, material furnished, labor performed, or on account of contracts made by him," it was held that he could not issue certificates in payment for materials until they had been actually furnished.²

§ 2064. **Misapplication by Receiver of Money borrowed.** — A person who lends money to a receiver duly authorized to borrow is under no obligation to see to the application by the receiver of the amount of the loan.³ Consequently the lender is entitled to recover notwithstanding a diversion of the money to improper channels.

§ 2065. **Laches of Lender.** — The rights of the lender to a preference may be lost by laches in the presentation of his claim.⁴ He cannot lie quiet while the property is sold and the proceeds of sale distributed, and then assert a claim against the purchaser or the distributees.⁵

§ 2066. **When Power of Court to create Preferential Claims ends.** — The power of the receiver with the approval of the court to contract or incur liabilities which shall be a prior lien on the assets continues as long as the receivership lasts — even after a sale. For instance, claims for rolling stock contracted by a receiver of a railway company after a sale but before delivery of possession to the purchaser may be decreed to attach to and

¹ *Hoover v. Montclair, etc. Ry. ter Trust, etc. Co. v. Oneonta, etc. Co.*, 29 N. J. Eq. 4 (headnote in *R. R. Co.*, 107 N. Y. Supp. 237. adequate).

² *Bank of Montreal v. Chicago, wha, etc. Ry. Co.*, 58 Fed. 6; 7 C. C. A. *etc. R. R. Co.*, 48 Iowa 518.

³ *Union Trust Co. v. Illinois* 686; 10 C. C. A. 587.
Midland Ry. Co., 117 U. S. 434, ⁵ *Mercantile Trust Co. v. Kana-*
461; 6 Sup. Ct. 809; *Stanton v. Ala., wha, etc. Ry. Co.*, 58 Fed. 6; 7 C. C. *etc. R. R. Co.*, 2 Woods 506; *Roches-* A. 3.

follow the assets into the purchaser's hands.¹ But as shown above, the purchaser in the absence of an assumption of claims contracted by the receiver is not liable for them to any greater extent than for claims contracted by the old corporation;² and the same rule applies to claims contracted or incurred by the receiver after the sale and before delivery of possession to the purchaser.³ After the purchaser takes possession, the power of the court in the foreclosure suit to adjudicate upon his liability for claims of any kind is at an end unless expressly reserved by the terms of the decree of sale;⁴ and *a fortiori* the court in the foreclosure case, after delivery of possession to the purchaser, retains no power to create new preferential claims against the purchaser. But until the purchase money is distributed, the bare power to create preferential claims against that fund undoubtedly continues, although with the exception of court costs and solicitor's fees, such claims are not usually contracted.

§ 2067. **Interest on Preferential Claims arising in Course of Receivership.** — Whether or not interest shall be paid on claims arising out of the receivership in preference to the mortgage bonds is a matter resting largely in the discretion of the court and to be determined upon the facts of each case.⁵ In one case, where the delay in payment was caused by resisting certain claims which the court finally disallowed, interest was refused to a car company on its preferential claim for rental of cars leased to the receiver of a railway company.⁶ So, interest has been refused on a claim founded on a judgment against the receiver for a tort committed by his servants in the management of the business.⁷ On the other hand, in some cases, notably where the receiver is authorized to borrow or issue receiver's certificates, interest is allowed as a matter of course. Indeed, under some circumstances the court may authorize a higher rate of interest to be paid on receivers' certificates than is allowed by usury laws

¹ *Vilas v. Page*, 106 N. Y. 439; interest on claims for taxes, see 13 N. E. 743. *First Nat. Bank v. Ewing*, 103 Fed. 168, 188-191; 43 C. C. A. 150.

² *Supra*, § 2035.

³ *Supra*, § 2034.

⁴ *Supra*, § 2035, § 2031.

⁵ Cf. *Grand Trunk Ry. Co. v. Central Vt. R. Co.*, 91 Fed. 569 (interest disallowed); *South Carolina v. Port Royal, etc. Ry. Co.*, 89 Fed. C. C. A. 143. ⁶ *Thomas v. Western Car Co.*, 149 U. S. 95; 13 Sup. Ct. 824. ⁷ *Ex parte Brown*, 18 S. Car. 87. But see *Central Trust Co. v. Denver, etc. R. Co.*, 97 Fed. 239; 33

565 (interest disallowed). As to

in force at the time of the issue,¹ although upon this point some authorities take a contrary view.²

§ 2068. **Whether Expenses of Receivership attach to Purchase Money or bind the Property in Hands of Purchaser.** — Ordinarily, claims growing out of a receivership, whether for money borrowed or the like, while taking precedence over the bonds or debentures, do not constitute a lien on the property which will bind it in the hands of a purchaser, but instead attach to the purchase money.³ The court has, however, *power* to decree that such claims shall be a lien on the property even in the hands of a purchaser;⁴ and the purchaser then assumes and becomes liable for them.⁵

§ 2069. **Priorities *inter sese* of Claims having Priority over the Mortgage Bonds.** — As to the rules of priority between these various preferential claims, all of which have priority over the bonds or debentures of the company, the decided cases have but little to say. The explanation of this dearth of authority doubtless lies in the fact that usually the assets are sufficient to pay in full all claims which have priority over the bonds or debentures. The United States Supreme Court has enunciated the principle that all such preferential claims except claims for taxes and claims upon receiver's certificates issued for payment of taxes, rank *pari passu*.⁶ But surely this statement is too sweeping. At all events in England somewhat elaborate rules have been laid down in a number of cases as to the priorities *inter sese* of claims all of which outrank the debentures.⁷ Some American cases likewise indicate a disposition to discriminate among such preferential claims, and give some of them preferences over the others.⁸ So, it has been held that receiver's certificates issued

¹ *Union Trust Co. v. Illinois*, 480-481; 6 Sup. Ct. 809; *First Nat. etc. Ry. Co.*, 117 U. S. 434, 452, 461; *Bank v. Ewing*, 103 Fed. 168, 195; 6 Sup. Ct. 809.

² *Meyer v. Johnston*, 53 Ala. 237, 351-352.

³ *Supra*, § 2035.

⁴ *Vilas v. Page*, 106 N. Y. 439; 13 N. E. 743; *Sloan v. Central Iowa Ry. Co.*, 62 Iowa 728; 16 N. W. 331; *Central Trust Co. v. Sloan*, 65 Iowa 655; 22 N. W. 916.

⁵ See *supra*, § 2035.

⁶ *Union Trust Co. v. Illinois Midland Ry. Co.*, 117 U. S. 434,

⁷ *Batten v. Wedgewood Coal Co.*, 28 Ch. D. 317; *Strapp v. Bull* (1895), 2 Ch. 1; *Lathom v. Greenwich Ferry Co.*, 72 L. T. 790; *Glasdir Copper Mines* (1906), 1 Ch. 365; *Smith v. London United Breweries* (1907), 2 Ch. 511.

⁸ *St. Paul Title, etc. Co. v. Diagonal Coal Co.*, 95 Iowa 551; 64 N. W. 606; *Petersburg, etc. Ins. Co. v. Dellatorre*, 70 Fed. 643; 17

for money borrowed by the receiver should have priority over claims for supplies, and the like, which are entitled under the rule in *Fosdick v. Schall* to a preference over the mortgage bonds.¹ Receiver's certificates which by their terms are declared to be a lien "after the payment of expenses and costs of administration" should be postponed to a claim for a tort committed by the servants of the receiver in the conduct of the business.² On the other hand, a claim for money borrowed by the receiver under an order of court and expressed to be a "first charge" on the property covered by the debentures, with the express proviso, however, that the receiver should not be subject to any personal liability therefor, has been held in England to be out-ranked by the receiver's claim for indemnity for outlays by him and for his compensation, at least where the lender is a party to the action.³

C. C. A. 310; *Crosby v. Morristown*,² *Anderson v. Condict*, 93 Fed. etc. R. R. Co. (Tenn.), 42 S. W. 507. 349; 35 C. C. A. 335; 94 Fed. 716;

¹ *Bank of Commerce v. Central* 36 C. C. A. 437.
Coal, etc. Co., 115 Fed. 878; 53
C. C. A. 334.
³ *Glasdir Copper Mines* (1906),
1 Ch. 365.

CHAPTER XXXI

BONDS AND MORTGAGES (CONTINUED) — REORGANIZATION — POWERS OF MAJORITY — INCOME BONDS

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§ 2070-§ 2091. REORGANIZATION AND REFUNDING.

§ 2070. **Incorporation of Purchasers at Foreclosure Sale.** — Foreclosure and sale is usually followed by reconstruction or reorganization — that is to say, the formation by the purchasers of a new corporation to carry on the old business or undertaking. We have seen above that in some cases of a so-called mortgage of the franchise to be a corporation the purchasers become, upon the completion of the purchase, *ipso facto* incorporated; and in other cases statutes make special provision for the organization of corporations by the purchasers at foreclosure sales.¹ More often, however, in these latter days, the new company is formed under the general laws; and the process does not differ legally from the formation of any new corporation.

§ 2071-§ 2086. REORGANIZATION AGREEMENTS.

§ 2071. **In general.** — The reorganization is generally accomplished under a comprehensive plan, assented to before the sale by all parties interested, whereby in order to remove troublesome

¹ See *supra*, § 1884. Cf. *Somerset Ry. v. Pierce*, 88 Me. 86; 33 Atl. 772.

though often unfounded objections, even junior encumbrancers, general creditors, and shareholders receive some interest in the new corporation.¹ The books disclose one instance in which it was seriously contended, and by a lower court actually held, that the new corporation had gone so far as to assume all the indebtedness of the old company, including the balance which after distribution of the proceeds of sale remained unpaid on bonds held by persons not assenting to the reorganization scheme.²

§ 2072. **Validity.** — That a reorganization agreement may by uniting the interests of possible purchasers tend to diminish competition at the foreclosure sale does not invalidate the arrangement.³ It has been held that a reorganization agreement will be fraudulent against the general creditors if shareholders in the old company receive some interest in the new whilst the general creditors are squeezed out altogether, and that it makes no difference in the application of this principle that the property may be worth much less than the secured indebtedness;⁴ but late decisions tend seriously to shake the authority of this proposition as a universal rule.⁵ The scheme of reorganization is not illegal because it may provide for the issue of new bonds in an amount greater than the old issue.⁶ The scheme of reorganization must of course be honest; for if it be a mere cover for the fraudulent object of enabling the officers and directors of the old company to “squeeze out” some of the shareholders, those shareholders will be entitled to claim their proportionate interest in the new company even though the scheme be carried out with

¹ A shareholder who is permitted *ex gratia* to participate in the profits of a reorganization agreement cannot dispute the validity of any of its terms. *Miller v. Dodge*, 28 N. Y. Misc. 640; 59 N. Y. Supp. 1070.

² *Fernschild v. Yuengling Brewing Co.*, 154 N. Y. 667; 49 N. E. 151.

³ *Venner v. Denver Union Water Co. (Colo.)*, 90 Pac. 623.

⁴ *Railroad Company v. Howard*, 7 Wall. 392; *Central of Georgia Ry. Co. v. Paul*, 93 Fed. 878; 35 C. C. A. 639 (where the reorganized company was held liable for the claim of the unsecured creditor).

Cf. *Hancock v. Toledo, etc. R. R.*

Co., 9 Fed. 738; *Pennsylvania Transportation Co.'s Appeal*, 101 Pa. St. 576; *Farmers' L. & T. Co. v. Missouri, etc. Ry. Co.*, 21 Fed. 264; *Louisville Trust Co. v. Louisville, etc. Ry. Co.*, 174 U. S. 674; 19 Sup. Ct. 827; *St. Louis Trust Co. v. Des Moines, etc. Ry. Co.*, 101 Fed. 632.

⁵ *Wenger v. Chicago, etc. R. Co.*, 114 Fed. 34; 51 C. C. A. 660; *Farmers' L. & T. Co. v. Louisville, etc. Ry. Co.*, 103 Fed. 110; *Paten v. Northern R. R. Co.*, 85 Fed. 838.

⁶ *Cushman v. Bonfield*, 36 Ill. App. 436.

all the forms of law by foreclosure and sale.¹ A bill to set aside as fraudulent a consummated plan of reorganization should make parties the shareholders and bondholders who assented to the plan and received benefits thereunder, or if they be too numerous to be conveniently joined, some of them may be made parties as the representatives of all.²

§ 2073. **Attitude of the Courts towards Reorganization Schemes.**

— Inasmuch as schemes for reorganization tend to promote bidding at the foreclosure sale³ and to prevent sacrifice and loss to all persons interested in the property, the court will incline to encourage the formation of reorganization syndicates⁴ and will refuse to throw obstacles in their way by compelling disclosure of their plans.⁵ Moreover, although the court should not take sides in any controversy between the bondholders, yet it will facilitate rather than hinder the only scheme of reconstruction known to exist.⁶

§ 2074. **Rule for Construction of Reorganization Agreement.** —

On the other hand, inasmuch as the reorganization committee prepares the reorganization agreement, that instrument should be construed most strongly in favor of the bondholders, who were compelled to accept it as it was or not to accept it at all.⁷

§ 2075-§ 2079. REORGANIZATION COMMITTEES.

§ 2075. **Liabilities of Committee.** — Reorganization is often begun by a purchase of the property at the foreclosure sale by a

¹ *Sparrow v. E. Bement & Sons*, 105 N. W. 881; 142 Mich. 441.

² *Ribon v. Railroad Cos.*, 16 Wall. 446.

³ See *Venner v. Denver Union Water Co.* (Colo.), 90 Pac. 623 (where the objection that a reorganization plan was invalid as tending to restrict competition was overruled).

⁴ *Robinson v. Philadelphia, etc. R. R. Co.*, 28 Fed. 340.

Cf. *Kropholler v. St. Paul, etc. Ry. Co.*, 2 Fed. 302; *Fidelity, etc. Vault Co. v. Mobile Street Ry. Co.*, 54 Fed. 26; *Cutter v. Iowa Water Co.*, 128 Fed. 505; *Land Title, etc. Co. v. Asphalt Co.*, 127 Fed. 1; 62 C. C. A. 23.

⁵ *Robinson v. Philadelphia, etc. R. R. Co.*, 28 Fed. 340.

⁶ *Platt v. Philadelphia, etc. R. R. Co.*, 65 Fed. 872. Cf. *Lake St. L. R. Co. v. Ziegler*, 99 Fed. 114, 129-130; 39 C. C. A. 431.

As to whether the receiver may become a member of a reorganization committee or otherwise promote a scheme of reconstruction, see *Fowler v. Jarvis-Conklin Mge. Co.*, 63 Fed. 888; *Clarke v. Central R. R., etc. Co.*, 66 Fed. 16.

⁷ *Industrial, etc. Trust v. Tod*, 180 N. Y. 215. 225 (headnote inadequate); 73 N. E. 7.

committee¹ in trust for those bondholders who may assent to the terms of the reorganization. In such a case the committee are trustees,² and are subject, therefore, to all the duties and liabilities of trustees.³ If they fail to comply with the scheme, or convey the property away in violation of their trust, a *cestui que trust* may hold them personally liable,⁴ or may follow the trust property into the hands of the assignee⁵ unless he be a purchaser for value without notice. This latter right exists even though the *cestui que trust* may have received his bonds back from the committee, with whom he had deposited them, and may have executed a release to the committee.⁶ It has been held that if the committee fail to turn over to the new corporation all the property which came into their hands, the former bondholders may call them to account without making the new company a party to the bill.⁷ A clause exempting the committee from liability except for fraud or gross negligence will be enforced, it seems, according to its terms.⁸

§ 2076-§ 2079. Powers of Reorganization Committees.

§ 2076. **In general.** — The details of the reorganization or reconstruction are usually intrusted to the reconstruction committee, upon whom wide, and sometimes almost arbitrary, powers are conferred.⁹ The law affords some slight protection

¹ Some trust company usually acts as reorganization committee or as agent or representative for the committee, and the law governing a trust company so acting is therefore here treated under the general head of reorganization committees.

² *Cox v. Stokes*, 156 N. Y. 491, 507; 51 N. E. 316.

³ As to the right to call upon the committee for an accounting, see *Mawhinney v. Converse*, 102 N. Y. Supp. 279.

⁴ Cf. *supra*, § 1833.

⁵ *Indiana, etc. R. R. Co. v. Swan-nell*, 157 Ill. 616; 41 N. E. 989; 30 L. R. A. 290.

Cf. *Browning v. Kelly*, 27 So. 391; 124 Ala. 645; *Kelly v. Brown-ing*, 113 Ala. 420; 21 So. 928.

⁶ *Indiana, etc. R. R. Co. v. Swan-nell*, 157 Ill. 616, 632; 41 N. E. 989; 30 L. R. A. 290.

⁷ *Dunning v. Bates*, 186 Mass. 123; 71 N. E. 309 (note, however, the well-reasoned dissenting opinion).

⁸ *Van Siclen v. Bartol*, 95 Fed. 793. Cf. *Mawhinney v. Converse*, 102 N. Y. Supp. 279; and *supra*, § 1836.

⁹ Cf. *Venner v. Fitzgerald*, 91 Fed. 335; *United Water Works Co. v. Omaha Water Co.*, 21 N. Y. Misc. 594; 48 N. Y. Supp. 817 (borrowing money by committee). As to alterations in the plan of reorganization, see *Barnard v. Fitzgerald*, 23 N. Y. Misc. 181; 50 N. Y. Supp. 309; and *infra*, § 2078, § 2085.

against the abuse of such powers. For instance, a provision that the construction of the contract by the committee shall be conclusive will not give the committee the unrestrained power to say what the contract means and to construe a vital provision out of it;¹ for the policy of the law strikes down any provision in a contract which would protect a party who acts in bad faith. But as to all matters which are by the scheme of reconstruction confided to the determination of a reorganization committee, their discretion cannot be controlled by the courts,² except in case of fraud, or, perhaps, of clear mistake respecting the considerations by which the determination ought to be influenced.³

§ 2077. **Power to levy Assessments.**—The power to levy assessments on the assenting bondholders and shareholders to defray the expenses of the reorganization is usually expressly conferred on the reorganization committee by the reconstruction agreement. Even apart from such express authority, it has been held that the power to levy such assessments may be implied from the very nature of the trust, and that if the agreement authorizes the committee to levy assessments to a certain amount they may nevertheless levy further assessments if found to be necessary.⁴ Where the amount of assessments to be made upon those who assent to the plan of reconstruction is confided to the discretion of the trust company which finances the reorganization, the trust company's determination on that point cannot be set aside or disregarded merely because the assessment may be unreasonably high.⁵ If honestly exercised, the trust company's discretion cannot be overruled. Nor is the trust company bound in such a case to give to those upon whom the assessments are to be levied notice of its intention to fix the amount thereof and an opportunity to be heard upon the question of what amount is proper:⁶ the trust company may act *ex parte*. If, however, in determining on the amount of the assessment the trust company

¹ *Industrial, etc. Trust v. Tod*, 180 N. Y. 215; 73 N. E. 7.

² *White v. Wood*, 129 N. Y. 527; 29 N. E. 835. Cf. *Mills v. Potter*, 189 Mass. 238; 75 N. E. 627 (where a commission was paid to one member of the committee).

³ *Gernsheim v. Central Trust Co.*, 16 N. Y. Supp. 127, 131; 61 Hun 625; 40 N. Y. St. Rep. 967 (semble).

⁴ *Cowell v. City Water Supply Co.*, 105 N. W. 1016; 130 Iowa 671.

⁵ *Gernsheim v. Central Trust Co.*, 16 N. Y. Supp. 127; 61 Hun 625; 40 N. Y. St. Rep. 967.

⁶ *Gernsheim v. Central Trust Co.*, 16 N. Y. Supp. 127; 61 Hun 625; 40 N. Y. St. Rep. 967.

has acted upon some palpably erroneous *principle*, it would seem that relief may be had in the courts.¹

§ 2078. **Power to alter Details of Plan.** — Although the committee have no implied power to alter the terms of the reorganization agreement,² yet by express provision very considerable latitude is sometimes allowed to them in altering some features of the plan. For instance, when the plan of reorganization provides for the issue of income bonds "payable in thirty years," a committee appointed to arrange the details of the scheme may provide that these income bonds shall be payable, at the option of the company, on or before the expiration of thirty years.³ But a power to determine the details of a plan of reorganization will not justify the committee in adopting substantially a new scheme.⁴ Even where the reconstruction agreement expressly provides that a majority of those assenting to the scheme may alter any of its features, the courts will whittle down by construction the generality of the power, so that an alteration in the fundamentals of the scheme cannot be made by a mere majority.⁵

§ 2079. **Duty to determine upon Details of Plan before Foreclosure.** — Where the details of the reorganization are to be submitted by the reorganization committee to the bondholders, who are thereupon to have the right severally to withdraw from the scheme or, if a majority of them withdraw, to defeat the scheme altogether, there is an implied promise on the part of the committee to submit a plan of reorganization before the foreclosure sale, and if they fail to do so, any one of the bondholders may have an action at law against them for damages.⁶ Obviously, the submission of a plan of reorganization *after* a foreclosure sale would be illusory.

¹ *Gernsheim v. Central Trust Co.*, 16 N. Y. Supp. 127, 131; 61 Hun 625; 40 N. Y. St. Rep. 967 (semble).

² *Cox v. Stokes*, 156 N. Y. 491; 51 N. E. 316.

³ *Lehigh, etc. Co. v. Central R. R. Co.*, 34 N. J. Eq. 88.

⁴ *United Water Works Co. v. Stone*, 127 Fed. 587; *United Water Works Co. v. Omaha Water Co.*, 164 N. Y. 41; 58 N. E. 58.

⁵ *Dutenhofer v. Adirondack Ry. Co.*, 14 N. Y. Supp. 558.

⁶ *Industrial, etc. Trust v. Tod*, 180 N. Y. 215; 73 N. E. 7.

§ 2080-§ 2086. *Rights of old Bondholders under Reorganization Schemes.*

§ 2080. **Time for assenting to the Plan.** — If the agreement or statute under which the reorganization is effected provides that holders of bonds or stock of the old company shall have, say, six months within which to assent to the scheme and claim their *pro rata* share therein, they lose all rights under the reorganization unless they assent within the time so limited, and no court has any power to relieve against this "forfeiture."¹ So if the plan of reorganization provides that stockholders in the old company in order to participate in the benefit of the reorganization, must make certain payments on their shares within such time as may be "lawfully limited" by the reorganization committee or trustees, the trustees may limit a time for this purpose without giving any notice thereof other than by publication,² and after the lapse of the time so limited all right to participate in the reorganization is forfeited.³ Even where no time is expressly limited, a bondholder will not be allowed to come in and claim his proportionate interest in the new company after the lapse of many years and after the company has become successful.⁴

§ 2081. **Necessity for Compliance with Agreement in order to secure its Benefits.** — In general, a bondholder who assents to the reorganization scheme but who fails to perform his part thereof cannot claim any benefits thereunder.⁵ For example, where the plan of reconstruction requires those who desire to claim its benefits to pay certain assessments in instalments, one who promptly paid the first instalment but failed to make punctual payment of the second cannot insist upon the same rights as if he had not been in default.⁶ On the other hand, under

¹ *Vatable v. New York, etc. R. R. Co.*, 96 N. Y. 49.

² *Thornton v. Wabash Ry. Co.*, 81 N. Y. 462.

³ *Vatable v. New York, etc. R. R. Co.*, 96 N. Y. 49.

⁴ *Landis v. Western Pa. R. R. Co.*, 133 Pa. St. 579.

⁵ *Carpenter v. Catlin*, 44 Barb. 75. See also *Fuller v. Venable*, 118 Fed. 543; 55 C. C. A. 309.

But cf. *Indiana, etc. R. R. Co. v. Swannell*, 157 Ill. 616; 41 N. E. 989; 30 L. R. A. 290.

⁶ *Dow v. Iowa Central Ry. Co.*, 70 Hun 186; 24 N. Y. Supp. 292. Cf. *Keane v. Moffly* (Pa.), 66 Atl. 319 (delay in paying assessment not ex-

some circumstances, a failure strictly to comply with terms and conditions of the scheme of reconstruction may be excused. For instance, under a plan of reorganization which required the bondholders to deposit their bonds and the amount of a specified assessment with a certain trust company, where a bondholder took his bond to the trust company in question who refused to receive it and referred him to the secretary of the reorganization committee, and the bondholder thereupon delivered the bond and paid the assessment to the secretary of the reorganization committee, the bondholder is entitled to full rights although the secretary subsequently deposited the bond with the trust company and took a receipt in his own name;¹ the trust company was merely the agent of the reorganization committee, and therefore delivery to the secretary of the committee, the principal, was no less efficacious than delivery to the trust company, the agent.

§ 2082. **Rights of Assenting Bondholders.** — Bondholders who have duly assented to the plan have a vested right, upon performing the conditions and stipulations on their part to be performed, to insist that the terms of the agreement be carried out. Even where the reorganization committee or the managers have an arbitrary discretion to exclude or admit whom they choose, yet a bondholder who by an agent has subscribed to the agreement cannot subsequently be excluded from its benefits because he is personally objectionable to the reorganizers.²

Where the plan of reorganization provides for the issue of stock in the new company at the rate of, say, ten shares for each bond, the meaning is that ten shares shall be issued for each bond and all unpaid coupons originally attached thereto; and the new company must not issue ten shares in respect of a bond and additional shares in respect of coupons detached therefrom.³

A person who takes bonds in the new or reorganized company has a right to insist upon the performance by the reorganization committee of a provision for "taking-up" (which means payment) of underlying bonds, and the committee will not be

excused because committee accepted payment from other persons after the time had expired). ² *Reed v. Schmidt*, 72 S. W. 367; 24 Ky. Law Rep. 1889.

¹ *Hitchcock v. Midland R. R. Co.*, 33 N. J. Eq. 86. ³ *Child v. New York, etc. R. R. Co.*, 129 Mass. 170, 173-174. Cf. *Fuller v. Venable*, 118 Fed. 543; 55 C. C. A. 309.

See also *Hitchcock v. Midland R. R. Co.*, 37 N. J. Eq. 549.

allowed against his objection to vary the scheme by extending the underlying bonds at a lower rate of interest.¹

§ 2083. **Within what Time the new Securities must be issued.** — Where the reconstruction agreement provides for the issue of securities of the new company within six months after “the date of the foreclosure sale,” the meaning is six months after the actual completion of the sale and transfer of possession, and not six months after the property was bid off or even after formal confirmation.²

§ 2084. **Certificates issued to assenting Bondholders as Evidence of Right to new Securities.** — Reorganization or refunding agreements often provide that on depositing the old securities with the reorganization committee or trustees, the bondholders shall receive certificates entitling them to a proportionate share of the new securities when issued.³ In such cases, if a certificate is wrongfully issued to a third person, the one really entitled to the new securities may file a bill against the trustees and the holder of the certificate to compel cancellation of the certificate and the issue of the new bonds to the plaintiff.⁴

§ 2085. **Effect of Departures from Plan in releasing assenting Bondholders.** — A substantial departure by the reorganizers from the scheme of reconstruction will release bondholders who have assented to the original plan but not to the alteration thereof from all obligation to abide by the reorganization, and justify them in retracting their assent and standing on their original rights.⁵ An increase in the amount of bonds to be issued by the new company from \$955,000 to \$1,200,000 is a substantial alteration in the scheme of reconstruction within the meaning of this rule.⁶

§ 2086. **Effect of Consummated Reorganization.** — The effect of the foreclosure sale is, ordinarily, to cut off all rights of the bondholders against the mortgaged property and to transfer their

¹ *Peoria, etc. Ry. Co. v. Coster*, 97 Fed. 519.

² *Houston, etc. Ry. Co. v. Keller*, 37 S. W. Rep. 1062; 90 Tex. 214.

³ As to whether such certificates are negotiable, see *Mercantile Trust, etc. Co. v. Low*, 87 Fed. 241; 30 C. C. A. 621. See also *supra*, § 237 and § 994.

⁴ *Turner v. Conant*, 18 Abb. N. C. (N. Y.) 160.

⁵ As to powers expressly vested in the reorganization committee to alter the plan, see *supra*, § 2078.

⁶ *Miller v. Rutland, etc. R. R. Co.*, 40 Vt. 399, 403-405; 94 Am. Dec. 413.

claims to the proceeds of sale; but as to any property not included in the charge, their right as general creditors in respect of any balance remaining unpaid on their bonds after distribution of the proceeds of sale is unaffected by the sale.¹ Bonds transferred to the new corporation are not ordinarily to be deemed paid, so as to prevent the new company from participating *pro rata* in the proceeds of sale.² Nevertheless, where in pursuance of a scheme of reconstruction bonds are deposited with a committee by whom the mortgaged property is bought in, the terms of the reorganization agreement read in the light of the surrounding circumstances may lead the court to conclude that on the completion of the purchase the bonds were to be deemed paid and discharged.³ And in the same way the claims of mere general creditors who are included in the scheme of reorganization and receive some interest in the new company may, upon the consummation of the reconstruction, be deemed fully satisfied and paid.⁴

§ 2087. **Reorganization under Provisions in the Mortgage Deed of Trust.** — Sometimes the deed of trust itself provides for reorganization,⁵ authorizing or directing the trustee to purchase at the foreclosure sale for the benefit of the bondholders, and to organize a new corporation, in which they shall be shareholders, to hold and manage the property. If the trustee is authorized by the mortgage to bid only after a written request by a majority of the bondholders, a bondholder who has consented to an order of court authorizing the trustee to bid up to a certain amount cannot object that the required written request had not been made, although the trustee bid more than the amount mentioned in the order of court.⁶ If the mortgage provides that the trustee on purchasing at the foreclosure sale shall proceed to organize a new corporation for the benefit of the bondholders in such manner

¹ Cf. *supra*, § 2039.

² Cf. *McEwen v. Harriman Land Co.*, 138 Fed. 797; 71 C. C. A. 163.

³ *Central Trust Co. v. Cincinnati, etc. Ry. Co.*, 58 Fed. 500.

⁴ *Central Trust Co. v. Cincinnati, etc. Ry. Co.*, 58 Fed. 500.

⁵ As to formation of a new or re-organized corporation by the purchasers, under a statute, see *supra*, § 1884. Cf. § 2070.

⁶ *James v. Cowing*, 82 N. Y. 449.

as the majority of them shall direct, the failure of the bondholders to give any directions as to the manner of forming the new company does not justify the trustee in disregarding the terms of the deed of trust and selling the property to another corporation.¹

§ 2088-§ 2091. *Reorganization without Foreclosure or Sale — Refunding.*

§ 2088. **In general.** — Often reorganization is effected, or sought to be effected, without a sale or foreclosure.² In such a case, the reconstruction is carried out under a plan or agreement which, in respect to its construction and so forth, is governed by the same principles that apply to a scheme of reorganization after foreclosure. The chief difference is that the existence of the old company continues unaltered, the only results of the reconstruction being the retirement of the old bonds or debentures, and generally also of the old capital stock, and the issue of new bonds and shares in their place.³

§ 2089. **Rights of dissenting Bondholders.** — In order that such an arrangement may be carried out, the unanimous consent of the bondholders is usually necessary; for, as we shall see, a majority of the bondholders have no power to bind a minority in the absence of some special power conferred by the bonds or the mortgage, or by statute. But whilst dissenting bondholders will not be bound by the agreement and may retain their original rights undiminished thereby, yet the court will lean against any construction thereof which would give them any advantage over the assenting bondholders. For instance, where a scheme of reorganization or refunding provides that the bondholders shall deposit their bonds with a reorganization committee, receiving in their stead bonds of a new issue, the delivery of their

¹ *James v. Cowing*, 82 N. Y. 449.

² For a curious case in which by a consent decree the receivership, properly so called, was terminated, and the receiver constituted a mere "managing agent" of the parties, see *Vermont & Canada R. R. Co. v. Vermont Central R. R. Co.*, 50 Vt. 500.

³ The issue of new debenture stock in exchange for debenture stock in pursuance of a re-funding scheme is taxable as an "issue of loan capital." *Attorney-General v. Regent's Canal & Dock Co.* (1904), 1 K. B. 263.

bonds by the assenting bondholders to the committee and the receipt of the new bonds in their place, will not amount to a cancellation of the old bonds so as to enable the non-assenting bondholders to foreclose the original mortgage for the benefit of themselves alone,¹ or to claim for interest more than their share of the earnings would have been had no bonds been surrendered.²

§ 2090. **Rights of assenting Bondholders.**—Whether the scheme is conditional upon unanimous acceptance by the bondholders, so that if any bondholders dissent those who have deposited their bonds will be entitled to have them back, or whether in that contingency the bonds of the concurring bondholders are to be held by the committee as collateral for the new securities,³ is a question of intention which the courts approach without bias or inclination one way or the other. Where there is a refunding agreement by which, for example, overdue coupons are exchanged for bonds, the courts will nevertheless be dis-

¹ *Mowry v. Farmers' L. & T. Co.*, 76 Fed. 38; 22 C. C. A. 52. Cf. *Gibbes v. G. & C. R. R. Co.*, 13 S. Car. 228; *Ames v. New Orleans, etc. R. R. Co.*, 2 Woods 206; *Anthony v. Campbell*, 112 Fed. 212; 50 C. C. A. 195 (where the assenting bondholders accepted in exchange debentures of a new company to which the old company had transferred all its assets); *Columbus, etc. R. R. Co. Appeals*, 109 Fed. 177, 205 et seq.; 48 C. C. A. 275 (as to the rights of a junior lienor who had not assented to reorganization agreement and was not a party to foreclosure suit); *Burlington City Loan, etc. Co. v. Princeton Lighting Co.* (N. J.), 67 Atl. 1019.

But see *New York Security, etc. Co. v. Louisville, etc. R. Co.*, 102 Fed. 382; *First Nat. Bank v. Radford Trust Co.*, 80 Fed. 569; 26 C. C. A. 1; *Maxwell Cattle Co. v. Henderson*, 56 Pac. 67; 12 Colo. App. 425.

A fortiori, a waiver of priority by holders of some of an issue of bonds in favor of junior incumbrancers will not entitle the non-assenting bondholders to the entire benefit of

the mortgage, to the exclusion of the assenting bondholders or those in whose favor they waive their rights. *Poland v. Lamoiville Valley R. R. Co.*, 52 Vt. 144.

² *Barry v. Missouri, etc. Ry. Co.*, 34 Fed. 829.

³ *Central Trust Co. v. Marietta, etc. Ry. Co.*, 73 Fed. 589. Cf. *Ames v. New Orleans, etc. R. R. Co.*, 2 Woods 206; *First Nat. Bank v. Radford Trust Co.*, 80 Fed. 569; 26 C. C. A. 1 (where the condition was waived by the assenting bondholders).

As to whether the agreement can be rescinded for failure on the part of the corporation to live up to its terms, see *Fidelity Ins., etc. Co. v. Shenandoah Valley R. R. Co.*, 33 W. Va. 761; 11 S. E. 58; *Columbus, etc. R. R. Co. Appeals*, 109 Fed. 177; 48 C. C. A. 275.

As to whether the deposited bonds are to be held as security for all the bonds of the new series or for such only of them as are exchanged for the old bonds, see *Burlington City Loan, etc. Co. v. Princeton Lighting Co.* (N. J.), 67 Atl. 1019.

inclined to hold the transaction equivalent to a complete novation, so as to deprive the assenting coupon holders of the benefit of the original mortgage.¹ A person who under a refunding agreement has exchanged old bonds for bonds of a new issue, can take no benefit from an alleged parol agreement by which he should be remitted to his original rights, if any of the holders of the old bonds should refuse to come in under the scheme, where the enforcement of that agreement would prejudice holders of the new bonds who had purchased in ignorance thereof.² Where a refunding agreement provides for a scaling down of the indebtedness by a surrender of the old bonds and the issuance of new bonds to a less amount, a bondholder who surrenders his old bonds and receives new ones to the amount of his proportionate share of the new indebtedness except as to a small fraction, less than the smallest sum for which bonds are issued under the agreement, is entitled in equity to the same lien for such fraction as if a bond therefor had been issued to him.³

§ 2091. **Whether Assent of the Shareholders is necessary to Refunding.** — Schemes of refunding without foreclosure or sale are usually carried out by the unanimous assent of shareholders as well as bondholders. But where the court is satisfied that by foreclosure the interests of the shareholders would certainly be wholly wiped out, it has been held that a scheme of reorganization which, without foreclosure or sale, provides for the obliteration of the interests of dissenting shareholders may nevertheless receive the judicial approval, and be put into execution by decree;⁴ the shareholders, if they prefer not to come in under the reorganization, are in no worse position than they would have been if foreclosure or sale had been had. This decision, however, is a very questionable one; for it would seem that the shareholders should be allowed to decide for themselves whether their rights in the event of a foreclosure sale would be worthless.

¹ *Gibert v. Washington City, etc.* compare *Hand v. Savannah, etc. R. R. Co.*, 33 Gratt. (Va.) 586, *R. R. Co.*, 17 S. Car. 219). 596-598. Cf. *Ames v. New Orleans,*

etc. R. R. Co., 2 Woods 206; *Virginia* ² *Ex parte White*, 2 S. Car. 469.

v. Chesapeake, etc. Canal Co., 35 ³ *Blair v. St. Louis, etc. R. Co.*, 23 Fed. 524. Md. 1.

⁴ *Carey v. Houston, etc. Ry. Co.*, But see *Hand v. Savannah, etc. R. R. Co.*, 12 S. Car. 314 (with which

§ 2092-§ 2099. *POWERS OF MAJORITY OF BOND-HOLDERS.*

§ 2092. **In the Absence of Provisions in Bonds or Mortgage affirmatively conferring Powers upon Majority.**—Both in the course of the receivership or in the process of reorganization and while the company retains the management of its own business, emergencies may arise in which some assent by the bondholders to some modification of their strict legal rights becomes practically very desirable. Nevertheless, as the bondholders are not incorporated or united in any way, a majority of them has no power to bind a minority, however small, unless by virtue of some affirmative provision in the bonds or deed of trust.¹ To be sure, the trustee of the mortgage has, usually, a certain amount of discretion; and in the exercise thereof he may properly enough be guided by the wishes of a majority of his *cestuis que trust*.² But whatever he may legally do with the assent of a majority of the bondholders, he may do, if he chooses, against the wishes of a majority,³ in the absence of some special provision in the bonds or mortgage. Moreover, no court has authority to sanction or

¹ *Gilfillan v. Union Canal Co.*, 109 U. S. 401, 404; 3 Sup. Ct. 304; *Canada Southern Ry. Co. v. Gebbard*, 109 U. S. 527, 534; 3 Sup. Ct. 363; *Nelson v. Hubbard*, 96 Ala. 238, 254-255; 11 So. 428; 17 L. R. A. 375; *First Nat. Bank v. Wyman*, 66 Pac. 456 (headnote inadequate); 16 Colo. App. 468; *Trust & Deposit Co. v. Spartanburg Water Co.*, 97 Fed. 409 (services rendered bondholders at instance of some of them no charge on fund realized by sale of mortgaged property). Cf. *Gates v. Boston, etc. R. R. Co.*, 53 Conn. 333; 5 Atl. 695; *De Betz's Petition*, 9 Abb. N. C. (N. Y.) 246.

But see *Waldoborough v. Knox, etc. R. R. Co.*, 84 Me. 469; 24 Atl. 942; *Lyman v. Kansas City, etc. R. Co.*, 101 Fed. 636, 642 (where the court said: "Each bondholder, by implication, is brought into contractual relations with every other bondholder analogous to that of

stockholders. As such, his individual notions and interests are so wrapped up and identified with those of his fellows that they must be measurably subordinated to the judgment and interests of the composite body. The single bondholder, representing only two per cent of the aggregate debt, like this complainant, may not, therefore, pursue such course in self-seeking as will be ruinous to the interests and rights of his fellow bondholders").

² *Shaw v. Railroad Co.*, 100 U. S. 605, 612; *First Nat. Bank v. Shedd*, 121 U. S. 74, 86; 7 Sup. Ct. 807.

So where the court has a discretionary power it will often be guided by the wishes of the majority of the bondholders. *Tysen v. Wabash Ry. Co.*, 8 Biss. 247.

³ Cf. *Sturges v. Knapp*, 31 Vt. 1; *Toler v. East Tenn., etc. Ry. Co.*, 67 Fed. 168.

validate an agreement entered into by the trustee, and a mere majority, however large, of the bondholders, whereby the rights of the bondholders are altered.¹

§ 2093—§ 2099. EXPRESS POWERS CONFERRED UPON MAJORITY
BY PROVISIONS IN BONDS OR MORTGAGE.

§ 2093. **In general.**—For this reason, corporation bonds, debentures, or mortgages not seldom provide that in certain cases the majority of the bondholders or debenture-holders shall have power to bind the minority. In England it is said that such powers are to be strictly construed;² but in the United States they would be perhaps more favorably regarded by the courts.³ In some jurisdictions, notably in England,⁴ the courts are by statute clothed with power to confirm “schemes of arrangement” between a company and its creditors. In exercising such a power, the court will not take into consideration a bill in Parliament, pending but not yet enacted into law, which is expected to increase the powers of the company.⁵

§ 2094. **Control of Courts over Discretion vested in Majority.**—Any power vested in the majority of the bondholders to bind the minority—for example, a power to extend the time for payment—must be exercised *bona fide* for the best interests of all. Otherwise the minority will not be concluded thereby but may enforce the bonds according to their original tenor.⁶ But, on the other hand, where any power is vested in the majority of the

¹ *Taylor v. Atlantic, etc. Ry. Co.*, v. *Gebbard*, 109 U. S. 527, 354–355; 55 How. Pr. (N. Y.) 275; *Lake St. El. R. Co. v. Ziegler*, 99 Fed. 114, 129–130; 39 C. C. A. 431. The execution of such an agreement will be enjoined. *Reinach v. Meyer*, 55 How. Pr. 283.

But see *Pollitz v. Farmers' L. & T. Co.*, 53 Fed. 210 (criticised supra, § 1829); *Saragossa, etc. Ry. Co. v. Collingham* (1904), A. C. 159, reversing *Collingham v. Sloper* (1901), 1 Ch. 769.

² *Mercantile Investment, etc. Co. v. International Co.* (1893), 1 Ch. 484 n.

³ Cf. *Canada Southern Ry. Co.*

3 Sup. Ct. 363.

But see *Farmers' L. & T. Co. v. Chicago, etc. Ry. Co.*, 27 Fed. 146, 153; *Dutenhofer v. Adirondack Ry. Co.*, 14 N. Y. Supp. 558.

⁴ See “Joint Stock Companies Arrangement Act, 1870,” 33 & 34 Vict. c. 104. For cases construing and applying this act, see *Inter-oceanic Ry. of Mexico*, 3 Manson 162; *Land Mortgage Bank of Florida*, 3 Manson 164.

⁵ *Eastern & Midlands Ry. Co.*, 67 L. T. 711.

⁶ *Hackettstown Nat. Bank v. Yuengling Brewing Co.*, 74 Fed. 110; 20 C. C. A. 327.

bondholders, their discretion cannot be controlled in the absence of bad faith: ¹ the minority bondholder, like a minority shareholder, can complain of the action of the majority only when it is in excess of their powers or fraudulent.

§ 2095-§ 2096. *How Will of Majority is determined.*

§ 2095. **By Writing.** — Where, by the bonds or deed of trust, some power is vested in the majority of the bondholders, it is customary to provide for a written authority or agreement signed by the majority. This requirement is dictated by convenience because, the bonds being payable to bearer, no record is kept of their holders, and the difficulty of convening a meeting is therefore very great.

§ 2096. **By Meeting of Bondholders.** — Sometimes, however, provision is made for meetings of the bondholders. In that event, if no method for convening the meeting is prescribed, notice by advertisement in newspapers published in the city at which the meeting is to be held will necessarily be sufficient.² If the provision is that at least fourteen days' notice of the meeting shall be given, it is sufficient if the advertisement was published fourteen clear days before the meeting, there being no necessity that the notice should be published in time to reach the bondholders fourteen days prior to the meeting.³ If the meeting adopts some resolution that is beyond its powers, a dissentient bondholder may file a bill to enjoin its execution, the defendants not being permitted to take shelter behind the proposition that the resolution if void is necessarily harmless.⁴

§ 2097. **General Power to bind Minority.** — A sweeping provision that a resolution passed by a majority at a meeting of debenture-holders shall bind all the holders as effectually as if

¹ *State v. Brown*, 73 Md. 484, 515-516; 21 Atl. 374. But cf. *v. International Co.* (1893), 1 Ch. *March v. Romare*, 114 Fed. 200 484 n. (stated infra, § 2098).

² *Mercantile Investment, etc. Co.* 1 Ch. 477, 493. Cf. *Reinach v. International Co.* (1893), 1 Ch. *Meyer*, 55 How. Pr. (N. Y.) 283. 484 n.

³ *Mercantile Investment, etc. Co.*

⁴ *Sneath v. Valley Gold Co.* (1893),

all had been present in person and assented thereto must be subject to some implied limitations or exceptions: at all events, it will not authorize the meeting to postpone payment of interest on the debentures, and permit moneys designated for that purpose by the deed of trust to be diverted to other objects.¹

§ 2098. **Miscellaneous Powers.** — A power to compromise cannot be exercised unless there is some dispute as to the right of the bondholders or debenture-holders, or some difficulty or obstacle in the way of enforcing them.² A power to modify the rights of the debenture-holders does not include a power to relinquish them;³ but it may be used to justify the creation of a loan or charge having priority over the debentures.⁴ A power to authorize the sale or other disposition of shares in two subsidiary companies which were owned by the obligor company and which constituted the bulk of the property covered by the mortgage deed of trust, for any purpose which will protect the security of the bonds in question or substitute therefor other security of equal or greater value, may justify a consolidation of the holding company with the two subsidiary companies under an arrangement whereby mortgage bonds of the amalgamated company are to be exchanged for the old bonds.⁵ A power to release the property or any part thereof charged with the lien of the debentures justifies a resolution providing for the issue of additional debentures to rank *pari passu* with those of the original issue.⁶ Of course, a power to release property from the lien of the bonds or debentures does not embrace a power to release the company itself.⁷ A power to waive a default in payment of interest cannot be exercised in anticipation of a future default, but requires the judgment of the bondholders upon the condition created by a

¹ *Hay v. Swedish, etc. Ry. Co.*, 484 n. Cf. *Ikelheimer v. Consolidated Tobacco Co.* (N. J.), 59 Atl. 5 Times L. R. 460. Cf. *Dutenhofer v. Adirondack Ry. Co.*, 14 363, 366 (headnote inadequate). N. Y. Supp. 558.

² *Mercantile Investment, etc. Co. Quarries* (1892), 3 Ch. 75; *Dominion v. International Co.* (1893), 1 Ch. 484 n. Cf. *Mercantile Investment, etc. Co. v. River Plate Trust Co.* (1894), 1 Ch. 578; *Sneath v. Valley Gold Co.* (1893), 1 Ch. 477; *Walker v. Elmore's, etc. Metal Co.*, 85 L. T. 767.

³ *Follit v. Eddystone Granite of Canada Co.*, 55 L. T. 347.

⁴ *Ikelheimer v. Consolidated Tobacco Co.* (N. J.), 59 Atl. 364.

⁵ *Walker v. Elmore's, etc. Metal Co.*, 85 L. T. 767.

⁶ *Mercantile Investment, etc. Co. v. International Co.* (1893), 1 Ch. 484 n.

⁷ *Mercantile Investment, etc. Co. v. International Co.* (1893), 1 Ch.

default already committed.¹ Even if a power to remove the trustee be vested in a majority of the bondholders, a court of equity will not permit them to exercise it merely because the trustee has performed his duty towards the minority bondholders.² Other powers given to the majority which have received judicial interpretation or consideration are the power to require the trustee to purchase at the foreclosure sale on behalf of the whole body of bondholders,³ and the implied power to veto the institution of foreclosure proceedings by the trustee.⁴

§ 2099. **When Powers may be exercised.** — Powers of compromise and the like vested in a majority of the security holders, or in their trustee, may be exercised even after the dissolution of the corporation.⁵

§ 2100-§ 2110. INCOME BONDS.

§ 2100. **Definition and Varieties of Income Bonds.** — A form of security which differs from the ordinary mortgage bond and which, although hardly common, is yet by no means rare is the income bond — that is to say, a bond which is secured by a charge upon the company's income but not upon the corpus of its property.

A bond secured by a mortgage of income may be so drawn that the obligation of the company is to pay in any event, although the security extends only to the income, or it may be that the company is bound to pay only in case sufficient income shall be earned.⁶ The latter form is usual in the case of American income bonds.⁷ Again, the payment of the principal may be

¹ *McClelland v. Norfolk Southern R. R. Co.*, 110 N. Y. 469, 477-479; 18 N. E. 237; 6 Am. St. Rep. 397; 1 L. R. A. 299.

² *March v. Romare*, 114 Fed. 200.

³ *Sage v. Central R. R. Co.*, 99 U. S. 334.

⁴ *Chicago, etc. R. R. Co. v. Fostick*, 106 U. S. 47, 76-79; 1 Sup. Ct. 10; *Farmers' L. & T. Co. v. Chicago, etc. Ry. Co.*, 27 Fed. 146.

See *supra*, § 1978, § 1980.

⁵ *Sneath v. Valley Gold Co.* (1893), 1 Ch. 477.

⁶ For cases construing bonds and mortgages with reference to this point, see *Texas, etc. Ry. Co. v. Marlor*, 123 U. S. 687, 698-700 (headnote inadequate); 8 Sup. Ct. 311; *Strauss v. United Telegram Co.*, 164 Mass. 130; 41 N. E. 57. Cf. *Barry v. Missouri, etc. Ry. Co.*, 27 Fed. 1.

⁷ For a possible objection to the negotiability of such bonds, see *supra*, § 1740 A.

secured by a mortgage of the corpus of the property, the interest being secured by a charge on the income only.¹

§ 2101. **Power to create a Charge upon the Income without charging the Corpus.** — In general, it is true, a mortgage or conveyance of the income of property will be construed as a mortgage or conveyance of the property itself;² but this rule is merely one of the presumed intention of the parties, and does not prevent a property-owner from creating by apt words a severance or distinction between the income and the corpus.³ We have already considered a charge upon income as incident to a charge upon the property from which it is derived, — cases, that is to say, in which the charge covers both the corpus and the income thereof; now, it remains to consider charges of income only — cases in which the charge covers the income alone and not the property from which it issues or by means of which it is earned.

§ 2102–§ 2104. *Nature of a Charge on Income Only.*

§ 2102. **In general.** — The *locus classicus* for explanation of a charge upon income only is *Gardner v. London, etc. Ry. Co.*⁴ In that case the court held that English railway debentures are secured by a charge upon the company's tolls, revenues, and income only, and not upon the corpus of the property, and proceeded to elucidate the distinction. Lord (then Sir H. M.) Cairns pointed out that a railway company is incorporated for public purposes "with internal and Parliamentary powers of management not to be interfered with," and, using an illustration which has since become classic, he declared that the company's undertaking could be regarded as a "fruit-bearing tree, the produce of which," and not the tree itself, "is the fund designated by the contract to secure and pay the debt. . . . The tolls and sums of money *ejusdem generis* — that is to say, the earnings of the undertaking — must be made available to satisfy the mortgage; but, in my opinion, the mortgagees cannot, under

¹ *Barry v. Missouri, etc. Ry. Co.*, 27 Fed. 1; *Day v. Ogdensburg, etc. R. R. Co.*, 107 N. Y. 129; 13 N. E. 765. ³ Cf. *Canal Company's Case*, 83 Md. 549; 35 Atl. 161, 354, 581. ⁴ *Gardner v. London, etc. Ry. Co.*, 2 Ch. 201.

² Cf. *State v. Northern Central Ry. Co.*, 18 Md. 193, 217–218.

their mortgages, or as mortgagees — by seizing, or calling on this court to seize, the capital, or the lands, or the proceeds of sales of land, or the stock of the undertaking — either prevent its completion, or reduce it into its original elements when it has been completed.”¹

§ 2103. **Relative Rights of Mortgagee of Income only and Judgment Creditor levying upon the Income.** — Since a mortgagee of income *only* has generally no right or power to take possession of the corpus of the property, his lien, if it is to have any efficacy at all, must have priority over an execution levied by an unsecured judgment creditor; and such is the law,² a distinction being generally drawn in this respect between a mortgage of income only and a mortgage of both corpus and income.³ It is rather curious that in this way a mortgagee of income alone has an apparent advantage over a mortgagee of both corpus and income.

§ 2104. **Rights of Mortgagee of Income against subsequent Mortgagee or Alienee of the Corpus.** — The pledge of income to secure income bonds is not a mere personal obligation of the debtor corporation, but is a lien or charge which attaches to the income of the property in the hands of any alienee — for example, in the hands of a consolidated corporation into which the original company has been amalgamated.⁴ Where income bonds have been issued, the company is nevertheless at liberty subsequently to issue bonds secured by a first mortgage of the body of its property;⁵ but it seems that in such a case the priority of the income bondholders will attach to income earned by the property when in the hands of the mortgagees of the principal or of a purchaser under that mortgage.⁶

§ 2105. **Unearned and overdue Coupons.** — Where the coupons on income bonds are payable only when sufficient in-

¹ *Gardner v. London, etc. Ry. Co., etc. Ry. Co.*, 24 N. Y. Misc. 646; 2 Ch. 201, 217, per Ld. Cairns. . . 53 N. Y. Supp. 749.

² *Macalester v. Maryland*, 114 U. S. 598; 5 Sup. Ct. 1065; *Ames v. Birkenhead Docks*, 20 Beav. 332; *Jessup v. Bridge*, 11 Ind. 572; 79 Am. Dec. 513.

³ *Supra*, § 1876, § 1877.

⁴ *Rutten v. Union Pac. Ry. Co.*, 17 Fed. 480. Cf. *Buel v. Baltimore*, § 2109).

⁵ *Ketchum v. St. Louis*, 101 U. S. 306.

come has been earned, interest runs on the coupons only after payment has been wrongfully refused — that is to say, refused notwithstanding a sufficiency of earnings.¹ Moreover, such unearned but overdue coupons (where the provision is that they are to accumulate) do not pass to the estate of a tenant for life who dies before sufficient profits to pay them are earned.²

If the company improperly passes a coupon when the earnings were sufficient to pay it, losses sustained by the company in subsequent years cannot be set off against liability for the passed coupon.³

§ 2106. **Comparison between Income Bonds and Preferred Shares.** — The general resemblance between the rights of income bondholders and the rights of preferred shareholders is apparent. The distinctions between the two, together with a consideration of anomalous forms of securities which lie close to the line, have already been adverted to in connection with the subject of preferred shares of capital stock.⁴

§ 2107. **Of the Question whether sufficient Income to pay Interest on Income Bonds has been earned.** — Whether or not the company has earned income sufficient for the payment of interest on its income bonds is a question which depends on considerations very similar to those which govern the question whether sufficient profits have been earned to justify or require the declaration of the dividend on preferred shares. Probably the courts would be more inclined to favor income bondholders than preferred shareholders, because of the position of the former as strangers to the company — creditors and not members; and in some cases the situation of income bondholders as creditors instead of members makes a marked distinction in their favor. Thus, interest on prior unsecured indebtedness cannot be paid out of earnings in preference to the interest on income bonds,⁵ although of course it not only could but must be paid in priority

¹ *Corcoran v. Chesapeake, etc. Canal Co.*, 1 MacA. (D. C.) 358 (headnote inadequate), affirmed on another ground, 94 U. S. 741.

² *Taylor's Trusts* (1905), 1 Ch. 734.

³ *Schmidt v. Louisville, etc. Ry. Co.*, 84 S. W. 314, 319; 27 Ky. Law Rep. 21.

⁴ *Supra*, § 546, § 547.

⁵ *Barry v. Missouri, etc. Ry. Co.*, 27 Fed. 1. Cf. *Buel v. Baltimore, etc. Ry. Co.*, 24 N. Y. Misc. 646; 53 N. Y. Supp. 749.

But as to payment of company's floating indebtedness, see *Lehigh Coal, etc. Co. v. Central R. R. Co.*, 34 N. J. Eq. 88.

to the dividend on preferred shares. At all events, the company's discretion to determine whether income applicable to the payment of interest on its income bonds has or has not been earned is not absolute, but must be exercised fairly with a due regard to its obligations towards the bondholders; and in any case of abuse or clear error, a determination adverse to the bondholders will be overridden by the courts.¹ This is true although the bonds provide that no interest shall be payable unless the directors certify that sufficient income has been earned.² The company, having passed one coupon, although the earnings were sufficient to pay it, cannot set off against its liability for the payment thereof losses sustained in subsequent years.³

The cost of issuing the bonds cannot be charged to the income account to the prejudice of the income bondholders.⁴ Whether expenditures for stores are chargeable to income or capital must be determined on the facts of each case.⁵ In one case it was held — upon what ground does not appear — that taxes and rents might properly be charged to capital.⁶ Very clearly, extensive improvements, amounting practically to the construction of a new line of railway, cannot be charged as operating expenses.⁷

¹ *Jamaica Ry. Co. v. Attorney-General of Jamaica* (1893), A. C. 127, 136-137 (headnote inadequate); *Morse v. Bay State Gas Co.*, 91 Fed. 938 (bondholder may have accounting in equity and is not restricted to action at law); *Edwards v. Bay State Gas Co.*, 91 Fed. 946 (same point); *Buel v. Baltimore, etc. Ry. Co.*, 24 N. Y. Misc. 646; 53 N. Y. Supp. 749.

Cf. *Barry v. Missouri, etc. Ry. Co.*, 27 Fed. 1; s. c. 34 Fed. 829 (headnote inadequate); s. c. 36 Fed. 228; *Spies v. Chicago, etc. R. Co.*, 30 Fed. 397 (headnote inadequate); *Morgan v. Union Pac. Ry. Co.*, 11 Fed. 692; *Thomas v. New York, etc. Ry. Co.*, 139 N. Y. 163; 34 N. E. 877. See also *Stewart v. Chesapeake, etc. Canal Co.*, 5 Fed. 149 (where, upon application by income bondholders, the court retained a bill in equity in order to require the company at stated in-

tervals to render accounts of its receipts and disbursements).

As to the right of an individual bondholder to sue when the trustee of the income mortgage refuses, etc. see *Buel v. Baltimore, etc. Ry. Co.*, 24 N. Y. Misc. 646; 53 N. Y. Supp. 749. Cf. *infra*, § 2110.

² *Thomas v. New York, etc. Ry. Co.*, 139 N. Y. 163, 181-182; 34 N. E. 877; *Spies v. Chicago, etc. R. Co.*, 40 Fed. 34.

³ *Schmidt v. Louisville, etc. Ry. Co.*, 84 S. W. 314, 319; 27 Ky. Law Rep. 21.

⁴ *Jamaica Ry. Co. v. Attorney-General of Jamaica* (1893), A. C. 127.

⁵ *Jamaica Ry. Co. v. Attorney-General of Jamaica* (1893), A. C. 127.

⁶ *Schmidt v. Louisville, etc. Ry. Co.*, 84 S. W. 314; 27 Ky. Law Rep. 21.

⁷ *Schmidt v. Louisville, etc. Ry. Co.*, 84 S. W. 314; 27 Ky. Law Rep. 21.

The issuance of income bonds does not, however, ordinarily prevent the company from enlarging its business and engaging in new enterprises; and hence a railway company may pay in preference to interest on its income bonds the rental reserved in a lease to it of a line of railroad executed after the issuance of the bonds:¹ such rental must be deducted before the net income which is subject to the charge can be ascertained. On the other hand, where a tramway company which had issued income bonds borrowed money for the purpose of introducing a system of electric traction, it was held that interest on the amount so borrowed might be charged to capital, and that a profit on revenue account being thus shown, the company might properly pay interest on the income bonds.² Debts incurred for the purpose of ordinary repairs and secured by a charge of future earnings may have a priority as to such earnings over previously issued income bonds.³ An income mortgage may be so drawn as to cover the net income from a particular part or branch of the company's business; and, where that is the case, the company must keep a separate account of earnings of that part or branch of its business, and cannot deduct therefrom, before paying interest on the income bonds, the expenses and losses incurred in carrying on new enterprises embarked upon after the issue of the bonds.⁴

§ 2108. **Cumulative and Non-cumulative Income Bonds.**—Where, as is usually the case, the interest on income bonds is payable only in the event that sufficient income is received, the question arises whether the interest is to accumulate in case sufficient income is not received during any interest period. This is similar to the question whether preferred shares are cumulative or non-cumulative. Presumably, the interest would be held to be *prima facie* cumulative. Although the interest is non-cumulative and is payable half-yearly, yet the terms of the bonds and of the laws and agreements under which they are issued may be such as to justify the conclusion that interest is not contingent on half-yearly profits, but that the account must be taken

¹ *Day v. Ogdensburgh, etc. R. R. State of Md.*, 32 Md. 501 (stated Co., 107 N. Y. 129; 13 N. E. 765. *infra*, § 2109).

² *Hinds v. Buenos Ayres, etc.* ⁴ *Spies v. Chicago, etc. R. Co.*, 40 *Tramways Co.* (1906), 2 Ch. 654. Fed. 34; 6 L. R. A. 565.

³ *Commonwealth of Virginia v.*

at the end of each year and not with semi-annual rests.¹ Where the provision is that, in case of insufficiency of earnings to pay accruing interest on the income bonds, scrip shall be issued therefor payable when the earnings shall be sufficient, the earnings of any interest period must be applied first in paying the coupons representing that period, before paying scrip issued under the provision above referred to.²

§ 2109. **Chesapeake & Ohio Canal Cases.**—The rights of income bondholders have been the subject of elaborate discussion in a series of somewhat peculiar Maryland cases relating to the Chesapeake and Ohio Canal. The state of Maryland in order to aid in the construction of the Chesapeake and Ohio Canal, which was deemed to be an enterprise of the greatest public importance, had made to the Canal Company a loan of several millions of dollars secured by a first mortgage of all the corporation's property and franchises. The aid thus extended having proved insufficient for the completion of the canal, the state agreed to waive its first lien as to the tolls and revenues of the company in favor of the holders of a series of income bonds to be issued by the corporation, with a proviso that notwithstanding the lien of the income bondholders the company should have the right to use the revenues in order to put and keep the canal in repair. Repairs subsequently being needed, the company, being without any revenue, borrowed money upon so called repair bonds secured by a first lien upon its future tolls and revenues. It was held by the Court of Appeals of Maryland that the power reserved to the corporation to devote its revenues to repairs, notwithstanding the charge securing the income bonds, in favor of which the state of Maryland had waived its priority, might be exercised by way of anticipation, and that future earnings should be applied, first, to the payment of principal and interest of the repair bonds and, second, to the payment of interest on the income bonds.³

Not even the money derived from all these sources sufficed to put the company permanently on a paying basis; but, on the contrary, on account of freshets and other disasters the concern

¹ *Jamaica Ry. Co. v. Attorney-General of Jamaica* (1893), A. C. 127. ³ *Commonwealth of Virginia v. State of Md.*, 32 Md. 501.

² *Barry v. Missouri, etc. Ry. Co.*, 27 Fed. 1 (headnote inadequate).

became hopelessly insolvent, no interest having been paid on the debt to the state and but very little on the income bonds. In this condition of affairs, the state demanded a sale of the property and franchises of the company under its mortgage, claiming that the priority of the income bondholders extended only to the tolls and revenues of the company and that a sale under the mortgage would pass a title free and clear of all claim of the income bondholders and that the proceeds of sale representing corpus and not income should be distributed to the state as holder of the first mortgage on the principal. There was no question but that by the terms of the income bonds the company was bound for the payment of interest whether or not the current income proved sufficient for that purpose. The questions were whether a sale should be decreed and as to the effect which such a sale if consummated would have. The court held that the parties were entitled as a matter of right to insist that prior to a sale a final determination should be had of the question whether the income bondholders would have any claim on the proceeds of sale;¹ and eventually decided that the priority of the income bondholders covered the tolls and revenues only, as distinguished from the corpus of the property, and that a sale under the state's mortgage would cut off and extinguish their rights, which would not attach to the proceeds of sale.² That the purchaser would take the property discharged from all claims of the income bondholders and that the revenues thereof in the hands of the purchaser would not be subject to the lien of the income bonds, seems to have been conceded by counsel and assumed by the court. Perhaps the contrary could not have been maintained, but the contention might well have been raised.³ The court further held that the State could not demand a sale under its mortgage unless and until it should clearly appear that the lien of the income bondholders was worthless and that the property could not be operated so as to produce revenue applicable to the payment of those bonds.⁴ In

¹ *State v. Brown*, 73 Md. 484, 515; 21 Atl. 374.

³ See *supra*, § 2104.

² *Canal Company's Case*, 83 Md. 21 Atl. 374; *Canal Company's Case*, 549, 578; 35 Atl. 161, 354, 581 83 Md. 549; 35 Atl. 161, 354, 581; (approving the opinion of Alvey, *State v. Cowen*, 94 Md. 487; 51 Atl. C. J., in *Brown v. Chesapeake*, etc. 171. *Canal Co.*, 73 Md. 567, 591-600).

⁴ *State v. Brown*, 73 Md. 484;

the meantime the court decreed that the property should be managed through receivers.

While these decisions are interesting and important, yet they arose upon very peculiar facts, the questions involved turning largely upon historical considerations. Hence, these cases should not be too readily relied upon as controlling authority in cases relating to ordinary private corporations.

§ 2110. **Remedies of Income Bondholders.** — The remedies of income bondholders in case the company makes default in payment of their interest are generally confined to requiring accounts of the receipts and disbursements.¹

Sometimes their trustee has power to enter into possession and collect the income for his *cestuis que trust*. And in every case of fraudulent mismanagement, deliberately persisted in, a court of equity has, it seems, inherent jurisdiction to appoint a receiver to collect the income instead of the corporation,² but a very strong case must be made out to justify such judicial intervention.³ As in the case of ordinary mortgage bonds, the trustee is the proper party to institute and prosecute any litigation for the vindication of their income mortgage. The individual income bondholders may sue only in case the trustee wrongfully refuses to do so, or in case other sufficient cause be shown; and the trustee is an indispensable party defendant to any such suit.⁴

The income bondholders have no right to apply like ordinary creditors for the winding-up or dissolution of the corporation.⁵

¹ *Stewart v. Chesapeake, etc. Canal Co.*, 5 Fed. 149. See also *supra*, § 2107, and cases there cited. 22 Fed. 631. Cf. *Buel v. Baltimore, etc. Ry. Co.*, 24 N. Y. Misc. 646.

² *Stewart v. Chesapeake, etc. Canal Co.*, 5 Fed. 149 (semble).

³ *Stewart v. Chesapeake, etc. Canal Co.*, 5 Fed. 149.

⁴ *Barry v. Missouri, etc. Ry. Co.*,

⁵ *Herne Bay Waterworks Co.*, 10 Ch. D. 42 (as to rights of holders of debentures issued by a waterworks company incorporated by special act of Parliament).

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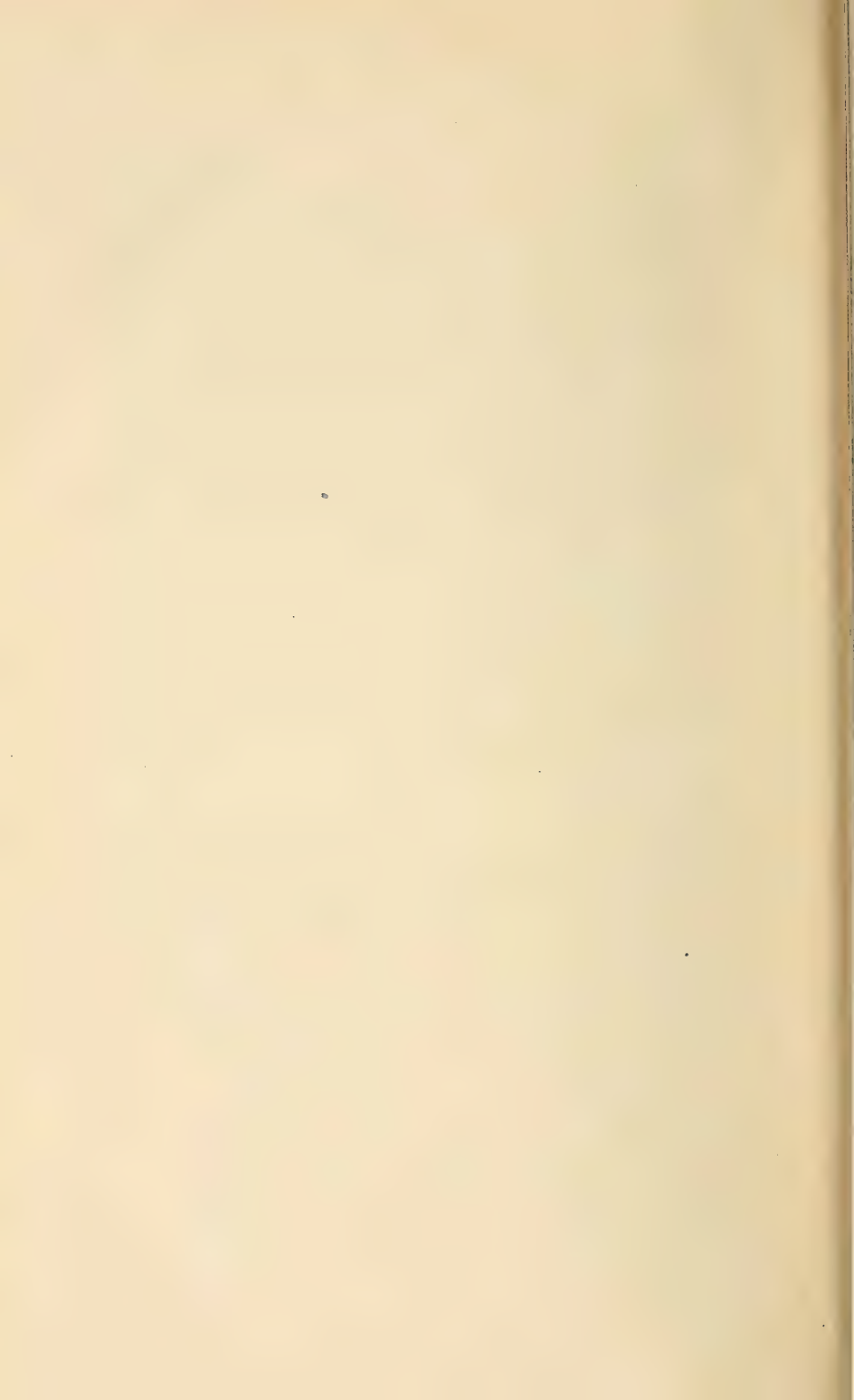
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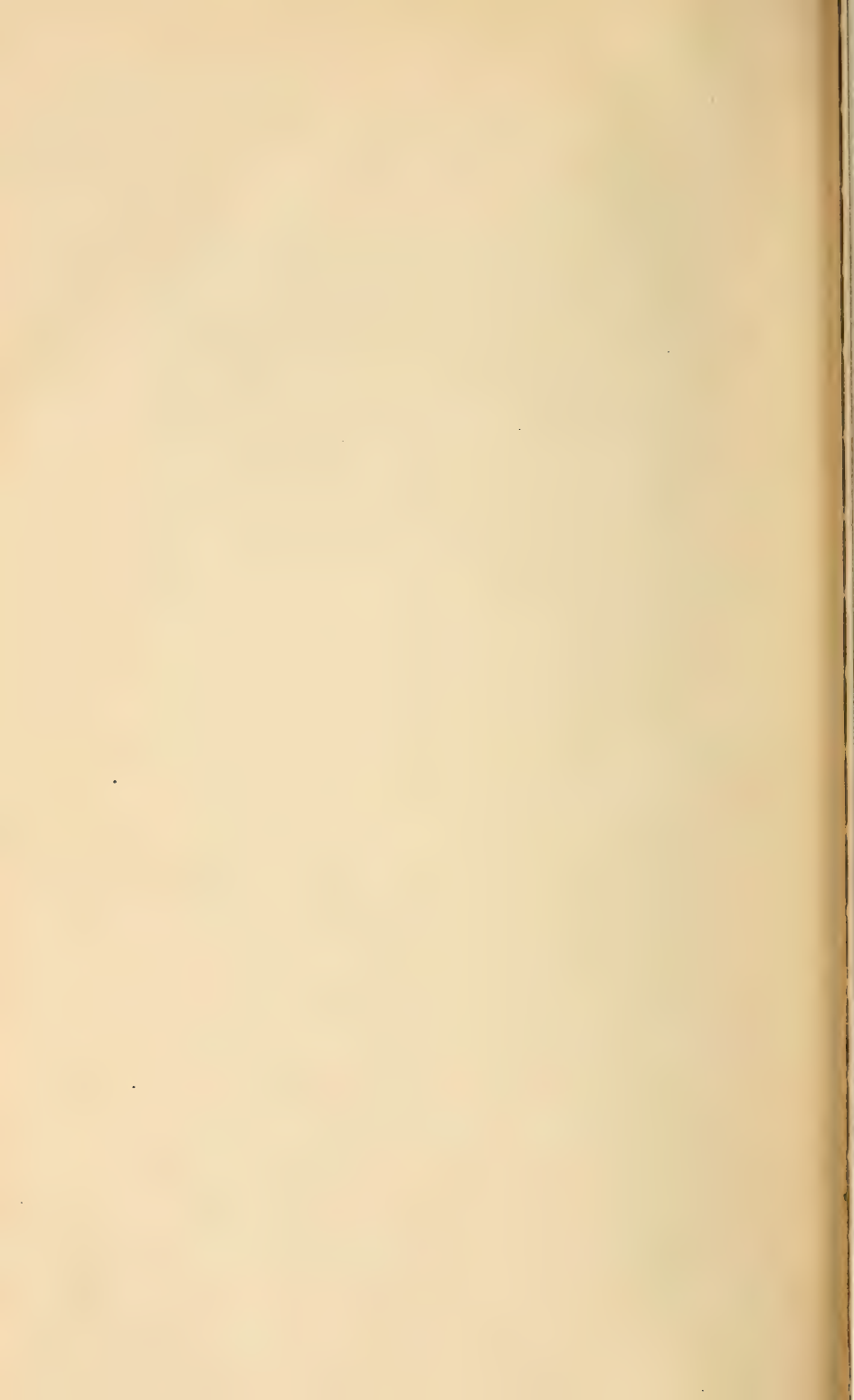
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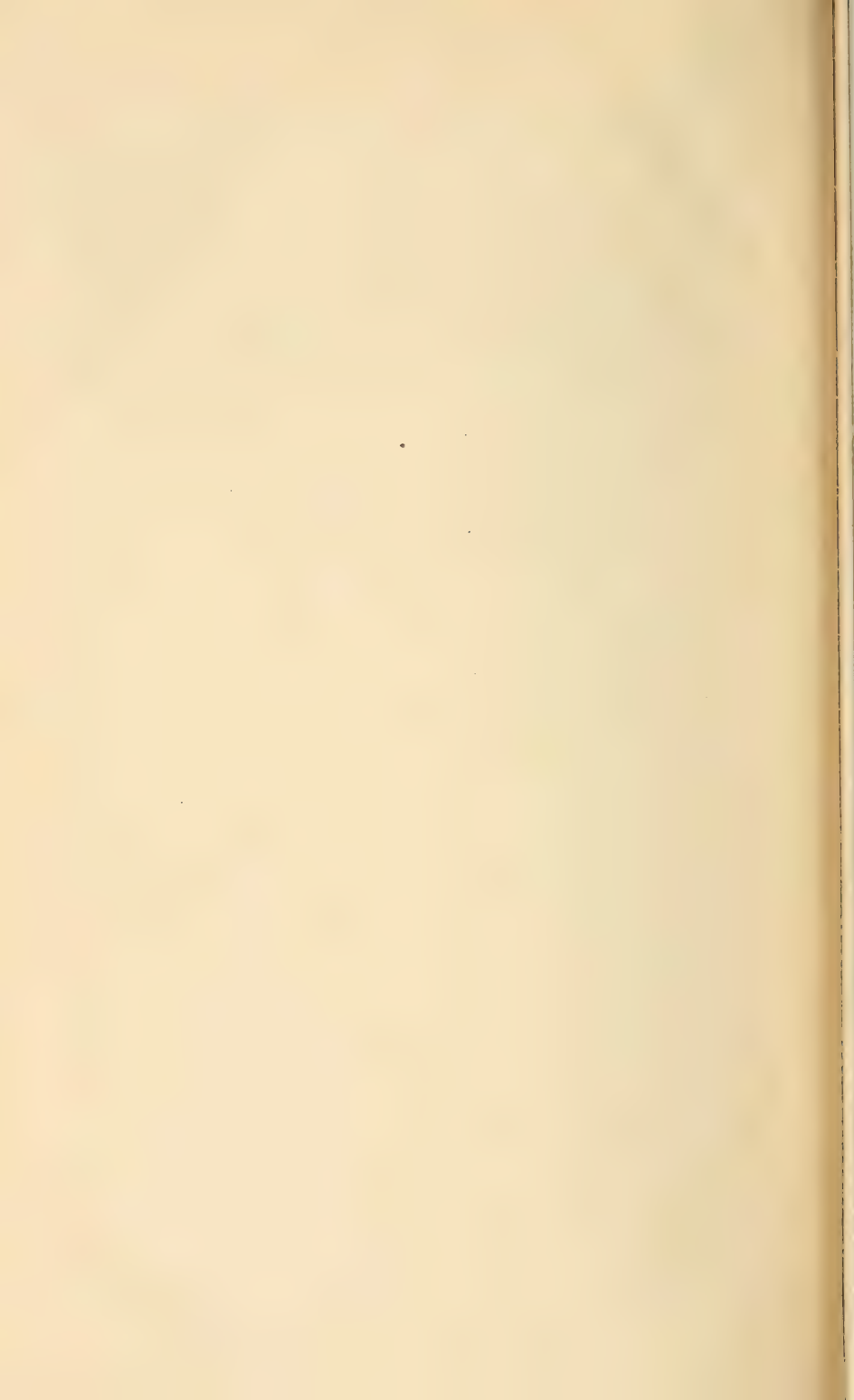
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